

NewStar Financial, Inc.  
Form 10-Q  
November 05, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-33211

NewStar Financial, Inc.

(Exact name of registrant as specified in its charter)

Delaware 54-2157878  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

500 Boylston Street, Suite 1250,

Boston, MA 02116  
(Address of principal executive offices) (Zip Code)

(617) 848-2500

(Registrant's telephone number, including area code)

N/A

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

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

As of November 2, 2015, 45,882,700 shares of common stock, par value of \$0.01 per share, were outstanding.

TABLE OF CONTENTS

	Page
PART I	
FINANCIAL INFORMATION	
Item 1. <u>Financial Statements (Unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014</u>	3
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2015 and 2014</u>	4
<u>Condensed Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2015 and 2014</u>	5
<u>Condensed Consolidated Statements of Changes in Stockholders' Equity for the Nine Months Ended September 30, 2015 and 2014</u>	6
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2015 and 2014</u>	7
<u>Notes to Condensed Consolidated Financial Statements</u>	9
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	39
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	61
Item 4. <u>Controls and Procedures</u>	62
PART II	
OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	62
Item 1A. <u>Risk Factors</u>	62
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	63
Item 6. <u>Exhibits</u>	64
<u>SIGNATURES</u>	66

Note Regarding Forward Looking Statements

This Quarterly Report on Form 10-Q of NewStar Financial, Inc., contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These are statements that relate to future periods and include statements about:

- our anticipated financial condition, including estimated loan losses;
- our expected results of operation;
- our growth and market opportunities;
- trends and conditions in the financial markets in which we operate;
- our future funding needs and sources and availability of funding;
- our involvement in capital-raising transactions;
- our ability to meet draw requests under commitments to borrowers under certain conditions;
- our competitors;
- our provision for credit losses;
- our future development of our products and markets;
- our ability to compete; and
- our stock price.

Generally, the words “anticipates,” “believes,” “expects,” “intends,” “estimates,” “projects,” “plans” and similar expressions identify forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause our actual results, performance, achievements or industry results to differ materially from any future results, performance or achievements expressed or implied by these forward-looking statements. These risks, uncertainties and other important factors include, among others:

- acceleration of deterioration in credit quality that could result in levels of delinquent or non-accrual loans that would force us to realize credit losses exceeding our allowance for credit losses and deplete our cash position;
- risks and uncertainties relating to the financial markets generally, including disruptions in the global financial markets;
- the market price of our common stock prevailing from time to time;
- our ability to obtain external financing;
- the regulation of the commercial lending industry by federal, state and local governments;
- risks and uncertainties relating to our limited operating history;
- our ability to minimize losses, achieve profitability, and realize our deferred tax asset; and
  - the competitive nature of the commercial lending industry and our ability to effectively compete.

For a further description of these and other risks and uncertainties, we encourage you to carefully read section Item 1A. “Risk Factors” of our Annual Report on Form 10-K, as amended, for the year ended December 31, 2014.

The forward-looking statements contained in this Quarterly Report on Form 10-Q speak only as of the date of this report. We expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement contained in this Quarterly Report to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any forward-looking statement is based, except as may be required by law.

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

## NEWSTAR FINANCIAL, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited

	September 30, 2015	December 31, 2014
	(\$ in thousands, except share	
	and par value amounts)	
<b>Assets:</b>		
Cash and cash equivalents	\$57,472	\$33,033
Restricted cash	140,854	95,411
Cash collateral on deposit with custodian	53,738	38,975
Investments in debt securities, available-for-sale	94,328	46,881
Loans held-for-sale, net	427,418	200,569
Loans and leases, net	2,991,370	2,305,896
Deferred financing costs, net	41,606	26,514
Interest receivable	9,668	7,477
Property and equipment, net	624	660
Deferred income taxes, net	35,627	28,078
Income tax receivable	—	3,388
Other assets	16,574	24,127
<b>Total assets</b>	<b>\$3,869,279</b>	<b>\$2,811,009</b>
<b>Liabilities:</b>		
Credit facilities	\$625,595	\$487,768
Term debt securitizations	1,890,765	1,193,187
Repurchase agreements	137,640	57,227
Senior notes	300,000	—
Corporate debt	—	238,500
Subordinated notes	189,852	156,831
Accrued interest payable	28,261	6,576
Income tax payable	3,352	-
Other liabilities	33,534	29,923
<b>Total liabilities</b>	<b>3,208,999</b>	<b>2,170,012</b>
<b>Stockholders' equity:</b>		
Preferred stock, par value \$0.01 per share (5,000,000 shares authorized; no shares outstanding)	—	—

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

Common stock, par value \$0.01 per share:

Shares authorized: 145,000,000 in 2015 and 2014;

Shares outstanding 45,846,553 in 2015 and 46,620,474 in 2014

Additional paid-in capital

Retained earnings

Common stock held in treasury, at cost \$0.01 par value; 9,147,127 in 2015 and 7,581,646

in 2014

Accumulated other comprehensive loss, net

Total stockholders' equity

Total liabilities and stockholders' equity

458	466
745,012	718,825
27,144	14,463
(109,175 )	(92,724 )
(3,159 )	(33 )
660,280	640,997
\$3,869,279	\$2,811,009

The accompanying notes are an integral part of these condensed consolidated financial statements.

## NEWSTAR FINANCIAL, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

Unaudited

	Three Months		Nine Months Ended	
	Ended		September 30,	September 30,
	2015	2014	2015	2014
	(\$ in thousands, except per share amounts)			
<b>Net interest income:</b>				
Interest income	\$54,574	\$33,907	\$141,194	\$100,570
Interest expense	31,345	14,304	84,764	40,673
Net interest income	23,229	19,603	56,430	59,897
Provision for credit losses	4,534	3,369	14,720	21,828
Net interest income after provision for credit losses	18,695	16,234	41,710	38,069
<b>Non-interest income (loss):</b>				
Fee income	4,573	740	10,508	1,972
Asset management income	1,019	488	2,954	543
Loss on derivatives	(5 )	(10 )	(24 )	(27 )
Gain (loss) on sale of loans, net	360	(23 )	314	(189 )
Other income (expense), net	(2,455 )	2,066	1,295	9,176
Total non-interest income	3,492	3,261	15,047	11,475
<b>Operating expenses:</b>				
Compensation and benefits	9,561	7,721	24,004	23,283
General and administrative expenses	3,819	3,260	11,052	11,481
Total operating expenses	13,380	10,981	35,056	34,764
Operating income before income taxes	8,807	8,514	21,701	14,780
<b>Results of Consolidated Variable Interest Entity:</b>				
Interest income	—	—	—	5,268
Interest expense – credit facilities	—	—	—	2,865
Interest expense – Fund membership interest	—	—	—	1,292
Other income	—	—	—	229
Operating expenses	—	—	—	249
Net results from Consolidated Variable Interest Entity	—	—	—	1,091
Income before income taxes	8,807	8,514	21,701	15,871
Income tax expense	3,665	3,494	9,020	6,503
Net income	\$5,142	\$5,020	\$12,681	\$9,368
Basic income per share	\$0.11	\$0.10	\$0.27	\$0.19
Diluted income per share	0.11	0.10	0.26	0.18

The accompanying notes are an integral part of these condensed consolidated financial statements.

NEWSTAR FINANCIAL, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Unaudited

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	2014	2015	2014	2015
	(\$ in thousands, except per share amounts)			
Net income	\$5,142	\$5,020	\$12,681	\$9,368
Other comprehensive income (loss), net of tax:				
Net unrealized securities gains (losses), net of tax expense				
(benefit) of \$(1,782), \$(78), \$(2,120) and \$(54), respectively	(2,583)	(108 )	(3,078 )	(79 )
Net unrealized derivative gains (losses), net of tax expense				
(benefit) of \$(14), \$4, \$(38) and \$0, respectively	(21 )	5	(48 )	(4 )
Other comprehensive income (loss)	(2,604)	(103 )	(3,126 )	(83 )
Comprehensive income	\$2,538	\$4,917	\$9,555	\$9,285

The accompanying notes are an integral part of these condensed consolidated financial statements.



## NEWSTAR FINANCIAL, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Unaudited

## NewStar Financial, Inc. Stockholders' Equity

For the Nine Months Ended September 30, 2015

	Additional		Retained Earnings	Treasury Stock	Accumulated	
	Common Stock	Paid-in Capital			Other Comprehensive Loss, net	Common Stockholders' Equity
	(\$ in thousands)					
Balance at January 1, 2015	\$466	\$718,825	\$14,463	\$(92,724)	\$ (33)	\$ 640,997
Net income	—	—	12,681	—	—	12,681
Other comprehensive income (loss)	—	—	—	—	(3,126)	(3,126)
Issuance of restricted stock	4	(4)	—	—	—	—
Net shares reacquired from employee transactions	(1)	1	—	(597)	—	(597)
Tax benefit from vesting of stock awards	—	(163)	—	—	—	(163)
Repurchase of common stock	(12)	12	—	(15,854)	—	(15,854)
Issuance of warrants	—	21,766	—	—	—	21,766
Exercise of common stock options	1	1,574	—	—	—	1,575
Tax benefit from exercise of common stock awards	—	551	—	—	—	551
Amortization of restricted common stock awards	—	2,450	—	—	—	2,450
Balance at September 30, 2015	\$458	\$745,012	\$27,144	\$(109,175)	\$ (3,159)	\$ 660,280

## NewStar Financial, Inc. Stockholders' Equity

For the Nine Months Ended September 30, 2014

	Additional		Retained Earnings	Treasury Stock	Accumulated		
	Common Stock	Paid-in Capital			Other Comprehensive Income, net	Earnings of Consolidated VIE	Common Stockholders' Equity
	(\$ in thousands)						
Balance at January 1, 2014	\$487	\$655,143	\$2,624	\$(43,271)	\$ 569	\$ 658	\$ 616,210
Net income	—	—	8,726	—	—	642	9,368
Other comprehensive income (loss)	—	—	—	—	(83)	—	(83)

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

Issuance of restricted stock	1	(1	)	—	—	—	—	—
Net shares reacquired from employee transactions	—	—	—	(525	)	—	—	(525
Tax benefit from vesting of stock awards	—	134	—	—	—	—	—	134
Repurchase of common stock	(16	)	5	—	(21,725)	—	—	(21,736
Exercise of warrants	3	15,244	—	(14,248)	—	—	—	999
Exercise of common stock options	3	279	—	—	—	—	—	282
Tax benefit from exercise of common stock awards	—	1,062	—	—	—	—	—	1,062
Reclassification of VIE Dividend	—	—	—	—	—	—	587	587
Deconsolidation of VIE	—	—	1,887	—	—	—	(1,887	)
Amortization of restricted common stock awards	—	1,796	—	—	—	—	—	1,796
Balance at September 30, 2014	\$478	\$673,662	\$13,237	\$(79,769)	\$486	\$-		\$608,094

The accompanying notes are an integral part of these condensed consolidated financial statements.

## NEWSTAR FINANCIAL, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

	Nine Months Ended September 30,	
	2015	2014
	(\$ in thousands)	
<b>Cash flows from operating activities:</b>		
Net income	\$ 12,681	\$ 9,368
<b>Adjustments to reconcile net income to net cash used for operations:</b>		
Provision for credit losses	14,720	21,828
Depreciation, amortization and accretion	(6,977 )	(9,062 )
Amortization of debt issuance costs	14,944	4,796
Equity compensation expense	2,450	1,796
(Gain) loss on sale of loans	(314 )	189
Unrealized loss on total return swap	971	—
Gain on sale of equipment	(471 )	—
Loss on other real estate owned	82	—
Loss from equity method investments	—	845
Net change in deferred income taxes	(5,394 )	3,551
Loans held-for-sale originated	(490,601 )	(169,104 )
Proceeds from sale of loans held-for-sale	263,231	137,072
Unrealized loss on loans held-for-sale	506	—
Net change in interest receivable	(2,191 )	2,179
Net change in other assets	6,587	(10,354 )
Net change in accrued interest payable	21,685	659
Net change in accounts payable and other liabilities	6,304	5,233
<b>Consolidated Variable Interest Entity:</b>		
Amortization of debt issuance costs	—	1,244
Depreciation and amortization and accretion	—	(315 )
Net change in interest receivable	—	1,079
Net change in other assets	—	946
Net change in accrued interest payable	—	(172 )
Net change in accounts payable	—	587
Net cash (used in) provided by operating activities	(161,787 )	2,365
<b>Cash flows from investing activities:</b>		
Net change in restricted cash	(45,443 )	36,115
Net change in loans	(692,212 )	37,681
Purchase of debt securities, available-for-sale	(85,020 )	(5,000 )
Proceeds from debt securities, available-for-sale	33,000	6,000
Proceeds from sale of other real estate owned	3,211	—
Acquisition of property and equipment	(129 )	(59 )
<b>Consolidated Variable Interest Entity:</b>		
Net change in loans	—	171,427
Net change in restricted cash	—	1,950
VIE cash dividends	—	(671 )

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

Net cash provided by (used in) investing activities	(786,593 )	247,443
Cash flows from financing activities:		
Proceeds from exercise of stock options, net	1,575	282
Tax benefit from exercise of stock options	551	1,062
Proceeds from exercise of warrants	—	999
Tax benefit (expense) from vesting of stock awards	(163 )	134
Advances on credit facilities	1,934,949	1,026,523
Repayment of borrowings on credit facilities	(1,797,122)	(1,074,333)
Issuance of term debt	824,167	289,500
Borrowings on term debt	43,500	94,100
Repayment of borrowings on term debt	(170,089 )	(331,821 )
Issuance of senior notes	300,000	—
Borrowing on subordinated notes	50,000	—
Borrowings on repurchase agreements	125,012	—
Repayment of borrowings on repurchase agreements	(44,599 )	(10,583 )
Repayment of corporate debt	(238,500 )	—
Posting of cash collateral	(14,763 )	—
Payment of deferred financing costs	(25,248 )	(4,617 )
Purchase of treasury stock	(16,451 )	(22,250 )

7

## NEWSTAR FINANCIAL, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS, continued

Unaudited

	Nine Months Ended September 30,	
	2015	2014
	(\$ in thousands)	
<b>Consolidated Variable Interest Entity:</b>		
Repayment of borrowings on credit facilities	—	(120,344)
Repayment of borrowings on subordinated debt	—	(30,000 )
Payment of deferred financing costs	—	(250 )
Net cash provided by (used in) financing activities	972,819	(181,598)
Net increase (decrease) in cash during the period	24,439	68,210
Cash and cash equivalents at beginning of period	33,033	43,401
Cash and cash equivalents at end of period	\$57,472	\$111,611
<b>Supplemental cash flows information:</b>		
Interest paid	\$63,079	\$39,581
Interest paid by VIE	—	4,763
VIE cash distribution	—	671
Taxes paid	7,285	3,664
Increase (decrease) in fair value of investments in debt securities, available for sale	(5,193 )	(133 )

The accompanying notes are an integral part of these condensed consolidated financial statements.

NEWSTAR FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

Note 1. Organization

NewStar Financial, Inc. is an internally-managed, commercial finance company with specialized lending platforms focused on meeting the complex financing needs of companies and private investors in the middle market. The Company is also a registered investment adviser and provides asset management services to institutional investors through a series of managed credit funds that co-invest in certain types of loans originated by the Company. Through its specialized lending platforms, the Company provides a range of senior secured debt financing options to mid-sized companies to fund working capital, growth strategies, acquisitions and recapitalizations, as well as, purchases of equipment and other capital assets.

These lending activities require specialized skills and transaction experience, as well as a significant investment in personnel and operating infrastructure. To meet these demands, our loans and leases are originated directly by teams of credit-trained bankers and experienced marketing officers organized around key industry and market segments. These teams represent specialized lending groups that are supported by centralized credit management and operating platforms, which enables us to leverage common standards, systems, and industry and professional expertise across multiple businesses.

The Company directs its marketing and origination efforts to private equity firms, mid-sized companies, corporate executives, banks, real estate investors and a variety of other referral sources and financial intermediaries to develop new customer relationships and source lending opportunities. The Company's origination network is national in scope and focuses on companies operating across a broad range of industry sectors. The Company employs highly experienced bankers, marketing officers and credit professionals to identify and structure new lending opportunities and manage customer relationships. The Company believes that the quality of its professionals, the breadth of their relationships and referral networks, and their ability to develop creative solutions for customers position it to be a valued partner and preferred lender for mid-sized companies and private equity funds with middle market investment strategies.

The Company's emphasis on direct origination is an important aspect of its marketing and credit strategy. Its national network is designed around specialized origination channels intended to generate a large set of potential lending opportunities. That allows each lending platform to be highly selective in its credit process and to allocate capital to market segments that we believe represent the most attractive opportunities. The Company's direct origination network also generates proprietary lending opportunities with yield characteristics that we believe would not otherwise be available through intermediaries. In addition, direct origination provides the Company with direct access to management teams and enhances its ability to conduct detailed due diligence and credit analysis of prospective borrowers. It also allows the Company to negotiate transaction terms directly with borrowers and, as a result, advise its customers on financial strategies and capital structures, which it believes benefits its credit performance.

The Company typically provides financing commitments to companies in amounts that range in size from \$10 million to \$50 million. The size of financing commitments depends on various factors, including the type of loan, the credit characteristics of the borrower, the economic characteristics of the loan, and the Company's role in the transaction. The Company also selectively arranges larger transactions that it may retain on its balance sheet or syndicate to other

lenders, which may include funds that it manages for third party institutional investors. By syndicating loans to other lenders and the Company's managed funds, it is able to provide larger financing commitments to its customers and generate fee income, while limiting our risk exposure to single borrowers. From time to time, however, the Company's balance sheet exposure to a single borrower may exceed \$30 million.

NewStar offers a set of credit products and services that have many common attributes, but which are highly specialized by lending group and market segment. Although both the Leveraged Finance and Business Credit lending groups structure loans as revolving credit facilities and term loans, the style of lending and approach to credit management is highly specialized. The Equipment Finance group broadens the Company's product offering to include a range of lease financing options. The operational intensity of each product also varies by lending group.

Although, the Company operates as a single segment, it derives revenues from lending activities and asset management services across four specialized lending groups that target market segments in which it believes that it has competitive advantages:

- Leveraged Finance, provides senior, secured cash flow loans and, to a lesser extent, first out, second lien and unitranche loans, which are primarily used to finance acquisitions of mid-sized companies with annual cash flow (EBITDA) typically between \$10 million and \$50 million by private equity investment funds managed by established professional alternative asset managers;
- Business Credit, provides senior, secured asset-based loans primarily to fund working capital needs of mid-sized companies with sales revenue typically totaling between \$25 million and \$500 million;

9

---

- Real Estate, provides first mortgage debt primarily to finance acquisitions of commercial real estate properties typically valued between \$10 million and \$50 million by professional commercial real estate investors;
- Equipment Finance, provides leases, loans and lease lines to finance equipment purchases and other capital expenditures typically for companies with annual sales of at least \$25 million; and
- Asset Management, provides opportunities for qualified institutions to invest in credit funds managed by the Company with strategies to co-invest in loans originated by its Leveraged Finance lending group.

## Note 2. Summary of Significant Accounting Policies

### Basis of Presentation

These interim condensed consolidated financial statements include the accounts of the Company and its subsidiaries (collectively, “NewStar”) and have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). All significant intercompany transactions have been eliminated in consolidation. These interim condensed financial statements include adjustments of a normal and recurring nature considered necessary by management to fairly present NewStar’s financial position, results of operations and cash flows. These interim condensed financial statements may not be indicative of financial results for the full year. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosure of contingent assets and liabilities. Actual results could differ from those estimates. The estimates most susceptible to change in the near-term are the Company’s estimates of its (i) allowance for credit losses, (ii) recorded amounts of deferred income taxes, (iii) fair value measurements used to record fair value adjustments to certain financial instruments, (iv) valuation of investments and (v) determination of other than temporary impairments and temporary impairments. The interim condensed consolidated financial statements and notes thereto should be read in conjunction with the Company’s Annual Report on Form 10-K, as amended, for the year ended December 31, 2014.

### Prior Period Reclassification

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

### Consolidation

On June 26, 2014, the NewStar Arlington Senior Loan Program LLC (the “Arlington Program”) completed a \$409.4 million term debt securitization comprised of all of the loans of NewStar Arlington Fund LLC (“Arlington Fund”) as well as a portion of the Company’s loans classified as held-for-sale. A portion of the proceeds from this term debt securitization were used to repay all advances under the Class A Notes and the Class B Notes. Following repayment, the Class A Notes and the Class B Notes were redeemed. The Company’s membership interests in Arlington Fund were also redeemed and new membership interests in the Arlington Program were issued to its equity investors. The Company acts as collateral manager for the Arlington Program. As a result of the repayment of the Company’s advances as the Class B lender under the warehouse facility and the redemption of its membership interests in the Arlington Fund, the Company has no ownership or financial interests in the Arlington Fund or its successors except to the extent that it receives management fees as collateral manager of the Arlington Program. Additionally, the Arlington Program employs an independent investment professional who is responsible for investment decision making on behalf of the program. As a result, the Company deconsolidated the Arlington Fund from its statement of financial position beginning on June 26, 2014. The Company is not the primary beneficiary of the Arlington Program and has not consolidated the Arlington Program’s operating results or statements of financial position as of that date.

### Recently Issued Accounting Standards

In September 2015, the FASB issued ASU 2015-16, Simplifying the Accounting for Measurement-Period Adjustments in Business Combinations (Topic 805). ASU 2015-16 eliminated the requirement to retrospectively



adjust the financial statements for measurement-period adjustments that occur in periods after a business combination is consummated. ASU 2015-16 is effective for annual periods and interim periods within that period beginning after December 15, 2015. Early adoption is permitted if financial statements were not issued. The Company does not expect that the adoption of ASU 2015-16 will have an impact on results from operations or financial position.

In April 2015, the FASB issued ASU 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with debt discounts. ASU 2015-03 is effective for the interim or annual period beginning after December 15, 2015. Adoption of ASU 2015-03 will not have an impact on the Company's results of operations but will reduce its total assets and liabilities by an equal amount within its statement of financial position.

In February 2015, the FASB issued ASU 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis. ASU 2015-02 changes the way reporting entities evaluate whether (a) they should consolidate limited partnerships and similar entities, (b) fees paid to a decision maker or service provider are variable interests in a variable interest entity ("VIE"), and (c) variable interests in a VIE held by related parties of a reporting entities require the reporting entity to consolidate the VIE. It also eliminates the VIE consolidation model based on majority exposure to variability that applied to certain investment companies and similar entities. The new consolidation guidance is effective for annual and interim periods in fiscal years beginning after December 15, 2015. At the effective date, all previous consolidation analyses that the guidance affects must be reconsidered. This includes the consolidation analyses for all VIEs and for all limited partnerships and similar entities that previously were consolidated by the general partner even though the entities were not VIEs. Early adoption is permitted, including early adoption in an interim period. If a reporting entity chooses to early adopt in an interim period, adjustments resulting from the revised consolidation analyses must be reflected as of the beginning of the fiscal year that includes that interim period. The Company is currently evaluating the impact that the adoption of ASU 2015-02 will have on results from operations or financial position.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 provides a framework that replaces existing revenue recognition guidance. ASU 2014-09 is effective for annual periods and interim periods within that reporting period beginning after December 15, 2017. Early adoption is not permitted. The Company is currently evaluating the impact that the adoption of ASU 2014-09 will have on results from operations or financial position.

### Note 3. Loans Held-for-Sale, Loans, Leases and Allowance for Credit Losses

Although the Company operates as a single segment, it derives revenues from asset management services and lending activities across four specialized lending groups that target market segments in which it believes it has competitive advantages:

- Leveraged Finance, provides senior, secured cash flow loans and, to a lesser extent, first out, second lien and unitranche loans, which are primarily used to finance acquisitions of mid-sized companies by private equity investment funds managed by established professional alternative asset managers;
- Business Credit, provides senior, secured asset-based loans primarily to fund working capital needs of mid-sized companies;
- Real Estate, provides first mortgage debt primarily to finance acquisitions of commercial real estate properties;
- Equipment Finance, provides leases, loans and lease lines to finance equipment purchases and other capital expenditures; and
- Asset Management, provides opportunities for qualified institutions to invest in credit funds managed by the Company with strategies to co-invest in loans originated by its Leveraged Finance lending group.

Loans classified as held-for-sale consist primarily of loans originated or purchased by the Company and intended to be sold to third parties (including credit funds managed by the Company). At September 30, 2015 loans held-for-sale consisted of \$431.8 million of leveraged finance loans.

These loans are carried at the lower of either market value or aggregate cost, net of any deferred origination costs or fees.

As of September 30, 2015 and December 31, 2014, loans held-for-sale consisted of the following:

	September 30,	December 31,
	2015	2014
	(\$ in thousands)	
Leveraged Finance	\$431,811	\$202,369
Gross loans held-for-sale	431,811	202,369
Deferred loan fees, net	(4,393 )	(1,800 )
Total loans held-for-sale, net	\$427,418	\$200,569

The outstanding balances of certain of these loans are in excess of the Company's target loan hold sizes. At September 30, 2015, loans held-for-sale include loans with an aggregate outstanding balance of \$429.7 million that were intended to be sold to credit funds managed by the Company. As of November 2, 2015, the Company had sold approximately \$17.4 million of the loans held-for-sale to credit funds managed by the Company. The Company sold loans with an aggregate outstanding balance of \$37.8 million for a net gain of \$0.3 million to entities other than credit funds managed by the Company during the nine months ended September 30, 2015. The Company sold loans with an outstanding balance of \$17.9 million for a net loss of \$0.2 million to entities other than credit funds during the nine months ended September 30, 2014.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

As of September 30, 2015, and December 31, 2014, loans and leases consisted of the following:

	September 30, 2015	December 31, 2014
	(\$ in thousands)	
Leveraged Finance	\$2,539,875	\$1,881,277
Business Credit	274,617	286,918
Real Estate	100,590	105,394
Equipment Finance	175,208	96,666
Gross loans and leases	3,090,290	2,370,255
Deferred loan fees, net	(45,808 )	(21,376 )
Allowance for loan and lease losses	(53,112 )	(42,983 )
Total loans and leases, net	\$2,991,370	\$2,305,896

The Company internally risk rates loans based on individual credit criteria on at least a quarterly basis. Borrowers provide the Company with financial information on either a quarterly or monthly basis. Loan ratings as well as identification of impaired loans are dynamically updated to reflect changes in borrower condition or profile. A loan is considered to be impaired when it is probable that the Company will be unable to collect all amounts due to it according to the contractual terms of the loan agreement. Impaired loans include all non-accrual loans, loans with partial charge-offs and loans which are troubled debt restructurings (“TDR”).

The Company utilizes a number of analytical tools for the purpose of estimating probability of default and loss given default for its four specialized lending groups. The quantitative models employed by the Company in its Leveraged Finance and Equipment Finance businesses utilize Moody’s KMV RiskCalc credit risk model in combination with a proprietary qualitative model, which generates a rating that maps to a probability of default estimate. Real Estate utilizes a proprietary model that has been developed to capture risk characteristics unique to the lending activities in that line of business. The model produces an obligor risk rating which corresponds to a probability of default and also calculates a loss given default. In each case, the probability of default and the loss given default are used to calculate an expected loss for those lending groups. Due to the nature of its borrowers and the structure of its loans, Business Credit utilizes a proprietary model that produces a rating that corresponds to an expected loss, without calculating a probability of default and loss given default. For consolidated variable interest entities for which the Company is providing transitional capital, a qualitative analysis is used to determine expected loss. In each case, the expected loss is the primary component in a formulaic calculation of general reserves attributable to a given loan.

Loans and leases which are rated at or better than a specified threshold are typically classified as “Pass”, and loans and leases rated worse than that threshold are typically classified as “Criticized”, a characterization that may apply to impaired loans, including TDR. As of September 30, 2015, \$151.5 million of the Company’s loans were classified as “Criticized”, including \$150.8 million of the Company’s impaired loans, and \$2.9 billion were classified as “Pass”. As of December 31, 2014, \$133.2 million of the Company’s loans were classified as “Criticized”, including \$121.8 million of the Company’s impaired loans, and \$2.2 billion were classified as “Pass”.

When the Company rates a loan above a certain risk rating threshold and the loan is deemed to be impaired, the Company will establish a specific allowance, if appropriate, and the loan will be analyzed and may be placed on non-accrual. If the asset deteriorates further, the specific allowance may increase, and ultimately may result in a loss and charge-off.

A TDR that performs in accordance with the terms of the restructuring may improve its risk profile over time. While the concessions in terms of pricing or amortization may not have been reversed and further amended to “market” levels, the financial condition of the Borrower may improve over time to the point where the rating improves from the “Criticized” classification that was appropriate immediately prior to, or at, restructuring.

As of September 30, 2015, the Company had impaired loans with an aggregate outstanding balance of \$201.2 million. Impaired loans with an aggregate outstanding balance of \$160.4 million have been restructured and classified as TDR. As of September 30, 2015, the aggregate carrying value of equity investments in certain of the Company’s borrowers in connection with troubled debt restructurings totaled \$11.5 million. Impaired loans with an aggregate outstanding balance of \$107.7 million were also on non-accrual status. For impaired loans on non-accrual status, the Company’s policy is to reverse the accrued interest previously recognized as interest income subsequent to the last cash receipt in the current year. The recognition of interest income on the loan only resumes when factors indicating doubtful collection no longer exist and the non-accrual loan has been brought current. During the three and nine months ended September 30, 2015, the Company had zero net charge offs and \$3.9 million in net charge offs, respectively of outstanding non-accrual loans. During the three and nine months ended September 30, 2015, the Company placed loans with an aggregate outstanding balance of \$7.0 million and \$29.3 million, respectively, on non-accrual status. During the three and nine months ended September 30, 2015, the Company recorded \$1.6 million and \$7.1 million, respectively, of net specific provisions for impaired loans. At September 30, 2015, the Company had a \$23.8 million specific allowance for impaired loans with an aggregate outstanding

balance of \$131.3 million. At September 30, 2015, additional funding commitments for impaired loans totaled \$10.3 million. The Company's obligation to fulfill the additional funding commitments on impaired loans is generally contingent on the borrower's compliance with the terms of the credit agreement and the borrowing base availability for asset-based loans, or if the borrower is not in compliance additional funding commitments may be made at the Company's discretion. As of September 30, 2015, \$20.1 million of loans on non-accrual status were greater than 60 days past due and classified as delinquent by the Company. Included in the \$23.8 million specific allowance for impaired loans was \$1.7 million related to delinquent loans.

As of December 31, 2014, the Company had impaired loans with an aggregate outstanding balance of \$217.2 million. Impaired loans with an aggregate outstanding balance of \$175.6 million have been restructured and classified as TDR. As of December 31, 2014, the aggregate carrying value of equity investments in certain of the Company's borrowers in connection with troubled debt restructurings totaled \$16.4 million. Impaired loans with an aggregate outstanding balance of \$87.8 million were also on non-accrual status. During 2014, the Company charged off \$18.8 million of outstanding non-accrual loans. During 2014, the Company placed loans with an aggregate outstanding balance of \$43.5 million on non-accrual status and returned loans with an aggregate outstanding balance of \$1.9 million to performing status. During 2014, the Company recorded \$22.2 million of net specific provisions for impaired loans. At December 31, 2014, the Company had a \$20.7 million specific allowance for impaired loans with an aggregate outstanding balance of \$103.2 million. At December 31, 2014, additional funding commitments for impaired loans totaled \$10.9 million. As of December 31, 2014, \$43.6 million of loans on non-accrual status were greater than 60 days past due and classified as delinquent by the Company. Included in the \$20.7 million specific allowance for impaired loans was \$8.7 million related to delinquent loans.

During 2012, as part of the resolution of two impaired commercial real estate loans, the Company took control of the underlying commercial real estate properties. During 2014, the Company sold one of the commercial real estate properties for \$9.5 million resulting in a gain on sale of \$0.01 million. During the three months ended September 30, 2015, the Company sold the remaining commercial real estate property for \$3.0 million resulting in a loss on sale of \$0.01 million.

A loan is considered impaired when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. The measurement of impairment of a loan is based upon (i) the present value of expected future cash flows discounted at the loan's effective interest rate, (ii) the loan's observable market price, or (iii) the fair value of the collateral if the loan is collateral dependent, depending on the circumstances and our collection strategy. Impaired loans are identified based on the loan-by-loan risk rating process described above. It is the Company's policy during the reporting period to record a specific provision for credit losses and/or partial or full charge off for all loans for which we have serious doubts as to the ability of the borrowers to comply with the present loan repayment terms.

A summary of impaired loans is as follows:

	Investment, Net		
	Investment, of	Unamortized	Unpaid
	Net of	Charge-offs	Principal
	Discount/Premium		
	(\$ in thousands)		
September 30, 2015			
Leveraged Finance	\$ 165,424	\$ 159,551	\$ 194,871
Business Credit	—	—	—
Real Estate	34,964	34,936	38,310

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

Equipment Finance	847	747	847
Total	\$ 201,235	\$ 195,234	\$ 234,028
December 31, 2014			
Leveraged Finance	\$ 164,886	\$ 160,223	\$ 186,002
Business Credit	—	—	366
Real Estate	52,309	52,230	55,661
Equipment Finance	—	—	—
Total	\$ 217,195	\$ 212,453	\$ 242,029

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

	Recorded	Recorded	Recorded	Recorded
	Investment with a Related Allowance for Credit Losses	Investment with a Related Allowance for Credit Losses	Investment without a Related Allowance for Credit Losses	Investment without a Related Allowance for Credit Losses
	(\$ in thousands)			
<b>September 30, 2015</b>				
Leveraged Finance	\$ 103,588	\$ 97,743	\$ 61,836	\$ 61,808
Business Credit	—	—	—	—
Real Estate	27,704	27,676	7,260	7,260
Equipment Finance	—	—	847	747
<b>Total</b>	<b>\$ 131,292</b>	<b>\$ 125,419</b>	<b>\$ 69,943</b>	<b>\$ 69,815</b>
<b>December 31, 2014</b>				
Leveraged Finance	\$ 103,159	\$ 98,528	\$ 61,727	\$ 61,695
Business Credit	—	—	—	—
Real Estate	—	—	52,309	52,230
Equipment Finance	—	—	—	—
<b>Total</b>	<b>\$ 103,159</b>	<b>\$ 98,528</b>	<b>\$ 114,036</b>	<b>\$ 113,925</b>

During the three months ended September 30, 2015, the Company did not record any charge-offs or recoveries, and during the nine months ended September 30, 2015 the Company recorded net partial charge-offs of \$3.9 million. During the three and nine months ended September 30, 2014, the Company recorded net partial charge-offs of \$0.6 million and \$21.2 million, respectively. The Company's policy is to record a specific allowance for an impaired loan to cover the identified impairment of that loan. Based on the Company's experience any potential charge-off of such loan would typically occur in a subsequent period. The Company may record the initial specific allowance related to an impaired loan in the same period as it records a partial charge-off in certain circumstances such as if the terms of a restructured loan are finalized during that period. When a loan is determined to be uncollectible, the specific allowance is charged off, which reduces the gross investment in the loan.

While charge-offs typically have no net impact on the carrying value of net loans and leases, charge-offs lower the level of the allowance for loan and lease losses; and, as a result, reduce the percentage of allowance for loans and leases to total loans and leases, and the percentage of allowance for loan and leases losses to non-performing loans.

Below is a summary of the Company's evaluation of its portfolio and allowance for loan and lease losses by impairment methodology:

September 30, 2015	Leveraged Finance		Business Credit		Real Estate		Equipment Finance	
	Investment	Allowance	Investment	Allowance	Investment	Allowance	Investment	Allowance
	(\$ in thousands)							
Collectively evaluated (1)	\$2,374,451	\$ 26,594	\$274,617	\$ 1,265	\$65,626	\$ 354	\$174,361	\$ 1,101
Individually evaluated (2)	165,424	23,724	—	—	34,964	74	847	—
<b>Total</b>	<b>\$2,539,875</b>	<b>\$ 50,318</b>	<b>\$274,617</b>	<b>\$ 1,265</b>	<b>\$100,590</b>	<b>\$ 428</b>	<b>\$175,208</b>	<b>\$ 1,101</b>



December 31, 2014	Leveraged Finance		Business Credit		Real Estate		Equipment Finance	
	Investment	Allowance	Investment	Allowance	Investment	Allowance	Investment	Allowance
(\$ in thousands)								
Collectively evaluated								
(1)	\$1,716,391	\$20,045	\$286,918	\$1,334	\$53,085	\$257	\$96,666	\$622
Individually evaluated								
(2)	164,886	20,725	—	—	52,309	—	—	—
Total	\$1,881,277	\$40,770	\$286,918	\$1,334	\$105,394	\$257	\$96,666	\$622

(1) Represents loans and leases collectively evaluated for impairment in accordance with ASC 450-20, Loss Contingencies, and pursuant to amendments by ASU 2010-20 regarding allowance for unimpaired loans and leases. These loans and leases had a weighted average risk rating of 5.1 at September 30, 2015 and at December 31, 2014, based on the Company's internally developed 12 point scale for the Leveraged Finance, Real Estate and Equipment Finance loans and leases. Business Credit Loans had a weighted average risk rating of 5.0 at September 30, 2015 and at December 31, 2014 based on the Company's internally developed 10 point scale for Business Credit loans.

(2) Represents loans individually evaluated for impairment in accordance with ASU 310-10, Receivables, and pursuant to amendments by ASU 2010-20 regarding allowance for impaired loans.

Below is a summary of the Company's investment in nonaccrual loans.

Recorded Investment in Nonaccrual Loans	September 30,	
	2015	December 31, 2014
	(\$ in thousands)	
Leveraged Finance	\$ 107,658	\$ 84,704
Business Credit	—	—
Real Estate	—	3,103
Equipment Finance	—	—
Total	\$ 107,658	\$ 87,807

Loans being restructured have typically developed adverse performance trends as a result of internal or external factors, the result of which is an inability to comply with the terms of the applicable credit agreement governing their obligations to the Company. In order to mitigate default risk and/or liquidation, assuming that liquidation proceeds are not viewed as a more favorable outcome to the Company and other lenders, the Company will enter into negotiations with the borrower and its shareholders on the terms of a restructuring. When restructuring a loan, the Company undertakes an extensive diligence process which typically includes (i) construction of a financial model that runs through the tenor of the restructuring term, (ii) meetings with management of the borrower, (iii) engagement of third party consultants and (iv) internal analysis. Once a restructuring proposal is developed, it is subject to approval by both the Company's Underwriting Committee and the Company's Investment Committee. Loans will only be removed from TDR classification after a period of performance following the refinancing of outstanding obligations on terms which are determined to be "market" in all material respects, or upon full payoff of the loan. The Company may modify loans that are not determined to be a TDR. Where a loan is modified or restructured but loan terms are considered market and no concessions were given on the loan terms, including price, principal amortization or obligation, or other restrictive covenants, a loan will not be classified as a TDR.

The Company has made the following types of concessions in the context of a TDR:

Group I:

- extension of principal repayment term
- principal holidays
- interest rate adjustments

Group II:

- partial forgiveness
- conversion of debt to equity

A summary of the types of concessions that the Company made with respect to TDRs at September 30, 2015 and December 31, 2014 is provided below:

	Group I	Group II
	(\$ in thousands)	
September 30, 2015	\$ 160,353	\$ 123,865
December 31, 2014	\$ 175,589	\$ 135,748

Note: A loan may be included in both restructuring groups, but not repeatedly within each group.

For the nine months ended September 30, 2015, the Company had \$4.0 million of partial charge-offs related to loans previously classified as TDR. As of September 30, 2015, the Company had not removed the TDR classification from any loan previously identified as such, but had charged-off, sold and received repayments of outstanding TDRs.

The Company measures TDRs similarly to how it measures all loans for impairment. The Company performs a discounted cash flow analysis on cash flow dependent loans and we assess the underlying collateral value less reasonable costs of sale for collateral dependent loans. Management analyzes the projected performance of the borrower to determine if it has the ability to service principal and interest payments based on the terms of the restructuring. Loans will typically not be returned to accrual status until at least six months of contractual payments have been made in a timely manner or the borrower shows significant ability to maintain servicing of the restructured debt. Additionally, at the time of a restructuring and quarterly thereafter, an impairment analysis is undertaken to determine the measurement of specific reserve, if any, on each impaired loan.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

Below is a summary of the Company's loans which were classified as TDR.

For the Nine Months Ended September 30, 2015	Pre-Modification	Post-Modification	Investment
	Outstanding	Outstanding	in TDR
	Recorded	Recorded	Subsequently
	Investment	Investment	Defaulted
	(\$ in thousands)		
Leveraged Finance	\$13,650	\$ 13,650	\$ 22,333
Business Credit	—	—	—
Real Estate	—	—	—
Equipment Finance	922	—	—
<b>Total</b>	<b>\$14,572</b>	<b>\$ 13,650</b>	<b>\$ 22,333</b>

For the Year Ended December 31, 2014	Pre-Modification	Post-Modification	Investment
	Outstanding	Outstanding	in TDR
	Recorded	Recorded	Subsequently
	Investment	Investment	Defaulted
	(\$ in thousands)		
Leveraged Finance	\$—	—	\$ 25,933
Business Credit	—	—	—
Real Estate	—	—	—
Equipment Finance	—	—	—
<b>Total</b>	<b>\$—</b>	<b>—</b>	<b>\$ 25,933</b>

The following sets forth a breakdown of troubled debt restructurings at September 30, 2015 and December 31, 2014:

As of September 30, 2015 (\$ in thousands)	Accrual Status		Impaired	Specific	For the nine months Charged-off
	Accruing	Nonaccrual			
Loan Type	Balance	Allowance	Balance	Allowance	Charged-off
Leveraged Finance	\$57,766	\$ 94,480	\$152,246	\$ 22,616	\$ 4,000
Business Credit	—	—	—	—	—
Real Estate	7,260	—	7,260	—	—
Equipment Finance	847	—	847	—	—
<b>Total</b>	<b>\$65,873</b>	<b>\$ 94,480</b>	<b>\$160,353</b>	<b>\$ 22,616</b>	<b>\$ 4,000</b>

As of December 31, 2014 Accrual Status For the year

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

Loan Type	(\$ in thousands)		Impaired Specific		
	Accruing	Nonaccrual	Balance	Allowance	Charged-off
Leveraged Finance	\$80,182	\$ 70,734	\$150,916	\$ 19,885	\$ 18,709
Business Credit	—	—	—	—	—
Real Estate	21,570	3,103	24,673	—	—
Equipment Finance	—	—	—	—	—
<b>Total</b>	<b>\$101,752</b>	<b>\$ 73,837</b>	<b>\$175,589</b>	<b>\$ 19,885</b>	<b>\$ 18,709</b>

The Company classifies a loan as delinquent when it is over 60 days past due.

An age analysis of the Company's delinquent receivables is as follows:

Loan Type	60-89 Days Greater than Past Due90 Days (\$ in thousands)		Total Past Due	Current	Total Loans and Leases	Investment in > 60 Days & Accruing
	September 30, 2015					
Leveraged Finance	\$-	\$ 28,587	\$28,587	\$2,511,288	\$2,539,875	\$ 8,530
Business Credit	—	—	—	274,617	274,617	—
Real Estate	—	—	—	100,590	100,590	—
Equipment Finance	—	—	—	175,208	175,208	—
<b>Total</b>	<b>\$-</b>	<b>\$ 28,587</b>	<b>\$28,587</b>	<b>\$3,061,703</b>	<b>\$3,090,290</b>	<b>\$ 8,530</b>

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

	60-89 Days Past Due (\$ in thousands)	Greater than 90 Days	Total Past Due	Current	Total Loans and Leases	Investment in > 60 Days & Accruing
<b>December 31, 2014</b>						
Leveraged Finance	\$25,412	\$ 18,151	\$43,563	\$1,837,714	\$1,881,277	\$ —
Business Credit	—	—	—	286,918	286,918	—
Real Estate	—	—	—	105,394	105,394	—
Equipment Finance	—	—	—	96,666	96,666	—
<b>Total</b>	<b>\$25,412</b>	<b>\$ 18,151</b>	<b>\$43,563</b>	<b>\$2,326,692</b>	<b>\$2,370,255</b>	<b>\$ —</b>

A general allowance is provided for loans and leases that are not impaired. The Company employs a variety of internally developed and third-party modeling and estimation tools for measuring credit risk, which are used in developing an allowance for loan and lease losses on outstanding loans and leases. The Company's allowance framework addresses economic conditions, capital market liquidity and industry circumstances from both a top-down and bottom-up perspective. The Company considers and evaluates a number of factors, including but not limited to, changes in economic conditions, credit availability, industry, loss emergence period, and multiple obligor concentrations in assessing both probabilities of default and loss severities as part of the general component of the allowance for loan and lease losses.

On at least a quarterly basis, loans and leases are internally risk-rated based on individual credit criteria, including loan and lease type, loan and lease structures (including balloon and bullet structures common in the Company's Leveraged Finance and Real Estate cash flow loans), borrower industry, payment capacity, location and quality of collateral if any (including the Company's Real Estate loans). Borrowers provide the Company with financial information on either a monthly or quarterly basis. Ratings, corresponding assumed default rates and assumed loss severities are dynamically updated to reflect any changes in borrower condition and/or profile.

For Leveraged Finance loans and Equipment Finance loans and leases, the data set used to construct probabilities of default in its allowance for loan losses model, Moody's CRD Private Firm Database, primarily contains middle market loans that share attributes similar to the Company's loans. The Company also considers the quality of the loan or lease terms and lender protections in determining a loan loss in the event of default.

For Business Credit loans, the Company utilizes a proprietary model to risk rate the loans on a monthly basis. This model captures the impact of changes in industry and economic conditions as well as changes in the quality of the borrower's collateral and financial performance to assign a final risk rating. The Company has also evaluated historical net loss trends by risk rating from a comprehensive industry database covering more than twenty-five years of experience of the majority of the asset based lenders operating in the United States. Based upon the monthly risk rating from the model, the reserve is adjusted to reflect the historical average for expected loss from the industry database.

For Real Estate loans, the Company employs two mechanisms to capture the impact of industry and economic conditions. First, a loan's risk rating, and thereby its assumed default likelihood, can be adjusted to account for overall commercial real estate market conditions. Second, to the extent that economic or industry trends adversely affect a substandard rated borrower's loan-to-value ratio enough to impact its repayment ability, the Company applies a stress multiplier to the loan's probability of default. The multiplier is designed to account for default characteristics that are difficult to quantify when market conditions cause commercial real estate prices to decline.

For consolidated VIEs to which the Company is providing transitional capital, we utilize a qualitative analysis which considers the business plans related to the entity, including expected hold periods, the terms of the agreements related to the entity, the Company's historical credit experience, the credit migration of the entity's loans in determining expected loss, as well as conditions in the capital markets.

If the Company determines that changes in its allowance for credit losses methodology are advisable, as a result of changes in the economic environment or otherwise, the revised allowance methodology may result in higher or lower levels of allowance. Moreover, given uncertain market conditions, actual losses under the Company's current or any revised allowance methodology may differ materially from the Company's estimate.

Additionally, when determining the amount of the general allowance, the Company supplements the base amount with an environmental reserve amount which is governed by a score card system comprised of ten individually weighted risk factors. The risk factors are designed based on those outlined in the Comptrollers of the Currency's Allowance for Loan and Lease Losses Handbook. The Company also performs a ratio analysis of comparable money center banks, regional banks and finance companies. While the Company does not rely on this peer group comparison to set the level of allowance for credit losses, it does assist management in identifying market trends and serves as an overall reasonableness check on the allowance for credit losses computation.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

A summary of the activity in the allowance for credit losses is as follows:

	Three Months Ended September 30, 2015				
	Leveraged	Business	Real	Equipment	Total
	Finance	Credit	Estate	Finance	
	(\$ in thousands)				
Balance, beginning of period	\$47,698	\$1,097	\$323	\$829	\$49,947
Provision for credit losses—general	2,443	168	42	272	2,925
Provision for credit losses—specific	1,550	—	59	—	1,609
Loans charged off, net of recoveries	—	—	—	—	—
Balance, end of period	\$51,691	\$1,265	\$424	\$1,101	\$54,481
Balance, end of period—specific	\$23,724	\$—	\$74	\$—	\$23,798
Balance, end of period—general	\$27,967	\$1,265	\$350	\$1,101	\$30,683
Average balance of impaired loans	\$170,933	\$—	\$35,218	\$—	\$206,151
Average net book value of impaired leases	\$—	\$—	\$—	\$884	\$884
Interest recognized from impaired loans and leases	\$2,672	\$—	\$400	\$15	\$3,087
Loans and leases					
Loans individually evaluated with specific allowance	\$103,588	\$—	\$27,704	\$—	\$131,292
Loans individually evaluated with no specific allowance	61,836	—	7,260	847	69,943
Loans and leases collectively evaluated without specific allowance	2,374,451	274,617	65,626	174,361	2,889,055
Total loans and leases	\$2,539,875	\$274,617	\$100,590	\$175,208	\$3,090,290

	Nine Months Ended September 30, 2015				
	Leveraged	Business	Real	Equipment	Total
	Finance	Credit	Estate	Finance	
	(\$ in thousands)				
Balance, beginning of period	\$41,480	\$1,334	\$257	\$622	\$43,693
Provision for credit losses—general	7,143	(69)	93	479	7,646
Provision for credit losses—specific	7,000	—	74	—	7,074
Loans charged off, net of recoveries	(3,932)	—	—	—	(3,932)
Balance, end of period	\$51,691	\$1,265	\$424	\$1,101	\$54,481
Balance, end of period—specific	\$23,724	\$—	\$74	\$—	\$23,798
Balance, end of period—general	\$27,967	\$1,265	\$350	\$1,101	\$30,683
Average balance of impaired loans	\$175,518	\$—	\$36,488	\$—	\$212,006
Average net book value of impaired leases	\$—	\$—	\$—	\$909	\$909
Interest recognized from impaired loans and leases	\$8,326	\$—	\$1,183	\$30	\$9,539

	Three Months Ended September 30, 2014				
	Leveraged	Business	Real	Equipment	Total
			Estate		



Edgar Filing: NewStar Financial, Inc. - Form 10-Q

	Finance	Credit		Finance	
	(\$ in thousands)				
Balance, beginning of period	\$33,786	\$1,060	\$3,634	\$ 619	\$39,099
Provision for credit losses—general	1,506	197	(50 )	(67 )	1,586
Provision for credit losses—specific	1,791	—	(8 )	—	1,783
Loans charged off, net of recoveries	(558 )	—	—	—	(558 )
Balance, end of period	\$36,525	\$1,257	\$3,576	\$ 552	\$41,910
Balance, end of period—specific	\$18,305	200	\$3,320	\$ —	\$21,825
Balance, end of period—general	\$18,220	\$1,057	\$256	\$ 552	\$20,085
Average balance of impaired loans	\$180,581	\$572	\$56,759	\$ —	\$237,912
Interest recognized from impaired loans	\$2,465	\$—	\$561	\$ —	\$3,026
Loans and leases					
Loans individually evaluated with specific allowance	\$106,402	\$236	\$30,871	\$ —	\$137,509
Loans individually evaluated with no specific allowance	64,948	—	25,673	—	90,621
Loans and leases collectively evaluated without specific allowance	1,521,849	225,414	52,739	75,726	1,875,728
Total loans and leases	\$1,693,199	\$225,650	\$109,283	\$ 75,726	\$2,103,858

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

	Nine Months Ended September 30, 2014				
	Leveraged Business			Equipment	
	Finance	Credit	Real Estate	Finance	Total
	(\$ in thousands)				
Balance, beginning of period	\$36,803	\$ 973	\$3,653	\$ 425	\$41,854
Provision for credit losses—general	1,801	284	(120 )	127	2,092
Provision for credit losses—specific	19,693	—	43	—	19,736
Loans charged off, net of recoveries	(21,772 )	—	—	—	(21,772 )
Balance, end of period	\$36,525	\$ 1,257	\$3,576	\$ 552	\$41,910
Average balance of impaired loans	\$177,904	\$ 525	\$57,641	\$ —	\$236,070
Interest recognized from impaired loans	\$8,356	\$ —	\$1,611	\$ —	\$9,967

Included in the allowance for credit losses at September 30, 2015 and December 31, 2014 is an allowance for unfunded commitments of \$1.4 million and \$0.7 million, respectively, which is recorded as a component of other liabilities on the Company's consolidated balance sheet with changes recorded in the provision for credit losses on the Company's consolidated statement of operations. The methodology for determining the allowance for unfunded commitments is consistent with the methodology for determining the allowance for loan and lease losses.

During the nine months ended September 30, 2015, the Company recorded a total provision for credit losses of \$14.7 million. The Company increased its allowance for credit losses to \$54.5 million as of September 30, 2015 from \$43.7 million at December 31, 2014 as a result of the increase in "Loans and leases, net" and an increase in the specific allowance for credit losses. The Company had \$0.1 million of recoveries of impaired loans with a specific allowance, decreased its general allowance for credit losses ratio (allowance for credit losses divided by outstanding gross loans and leases excluding loans held for sale) by three basis points during the nine months ended September 30, 2015, this is a result of the increased mix of recently originated loans as a percentage of the overall portfolio and recorded new specific provisions for credit losses of \$7.1 million. The general allowance for credit losses covers probable incurred losses in the Company's loan and lease portfolio with respect to loans and leases for which no specific impairment has been identified. When a loan is classified as impaired, the loan is evaluated for a specific allowance and a specific provision may be recorded, thereby removing it from consideration under the general component of the allowance analysis. Loans that are deemed to be uncollectible are charged off and deducted from the allowance, and recoveries on loans previously charged off are netted against loans charged off. A specific provision for credit losses is recorded with respect to impaired loans for which it is probable that the Company will be unable to collect all amounts due in accordance with the contractual terms of the loan agreement for which there is impairment recognized. The outstanding balance of impaired loans, which include all of the outstanding balances of the Company's delinquent loans and its troubled debt restructurings, as a percentage of "Loans and leases, net" was 7% and 9% as of September 30, 2015 and as of December 31, 2014, respectively.

The Company closely monitors the credit quality of its loans and leases which is partly reflected in its credit metrics such as loan delinquencies, non-accruals and charge-offs. Changes in these credit metrics are largely due to changes in economic conditions and seasoning of the loan and lease portfolio.

The Company continually evaluates the appropriateness of its allowance for credit losses methodology. Based on the Company's evaluation process to determine the level of the allowance for loan and lease losses, management believes the allowance to be adequate as of September 30, 2015 in light of the estimated known and inherent risks identified through its analysis.

Note 4. Restricted Cash

Restricted cash as of September 30, 2015 and December 31, 2014 was as follows:

	September 30, 2015	December 31, 2014
	(\$ in thousands)	
Collections on loans pledged to credit facilities	\$59,743	\$ 34,508
Principal and interest collections on loans held in trust and prefunding amounts	80,897	60,013
Customer escrow accounts	214	890
Total	\$140,854	\$ 95,411

As of September 30, 2015, the Company had the ability to use \$15.5 million of restricted cash to fund new or existing loans.

Note 5. Investments in Debt Securities, Available-for-Sale

Amortized cost of investments in debt securities as of September 30, 2015 and December 31, 2014 was as follows:

	September 30, 2015	December 31, 2014
	(\$ in thousands)	
Investments in debt securities—gross	\$ 108,318	\$ 53,098
Unamortized discount	(8,808 )	(6,228 )
Investments in debt securities—amortized cost	\$ 99,510	\$ 46,870

The amortized cost, gross unrealized holding gains, gross unrealized holding losses, and fair value of available-for-sale securities at September 30, 2015 and December 31, 2014 were as follows:

	Amortized cost (\$ in thousands)	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
September 30, 2015				
Collateralized loan obligations	\$ 99,510	\$ 22	\$ (5,204 )	\$ 94,328
	\$ 99,510	\$ 22	\$ (5,204 )	\$ 94,328

	Amortized cost (\$ in thousands)	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
December 31, 2014				
Collateralized loan obligations	\$ 46,870	\$ 214	\$ (203 )	\$ 46,881
	\$ 46,870	\$ 214	\$ (203 )	\$ 46,881

During the nine months ended September 30, 2015, the Company purchased \$85.0 million of debt securities.

The Company did not sell any debt securities during the nine months ended September 30, 2015 and 2014.

The Company did not record any net “Other-Than-Temporary Impairment” charges during the nine months ended September 30, 2015 and 2014.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

The following is an analysis of the continuous periods during which the Company has held investment positions which were carried at an unrealized loss as of September 30, 2015 and December 31, 2014:

	September 30, 2015		
	Greater than		
	Less than	or	Equal to
	12 Months	12 Months	Total
	(\$ in thousands)		
Number of positions	18	2	20
Fair value	\$82,688	\$ 6,558	\$89,246
Amortized cost	87,703	6,747	94,450
Unrealized loss	\$(5,015 )	\$(189 )	\$(5,204 )

	December 31, 2014		
	Greater than		
	Less than	or	Equal to
	12 Months	12 Months	Total
	(\$ in thousands)		
Number of positions	8	—	8
Fair value	\$38,740	\$ —	\$38,740
Amortized cost	38,943	—	38,943
Unrealized loss	\$(203 )	\$ —	—\$(203 )

As a result of the Company's evaluation of the securities, management concluded that the unrealized losses at September 30, 2015 and December 31, 2014 were caused by changes in market prices driven by interest rates and credit spreads. The Company's evaluation of impairment include quotes from third party pricing services, adjustments to prepayment speeds, delinquency, an analysis

of expected cash flows, interest rates, market discount rates, other contract terms, and the timing and level of losses on the loans and leases within the underlying trusts. At September 30, 2015, the Company has determined that it is not more likely than not that it will be required to sell the securities before the Company recovers its amortized cost basis in the security. The Company has also determined that there has not been an adverse change in the cash flows expected to be collected. Based upon the Company's impairment review process, and the Company's ability and intent to hold these securities until maturity or a recovery of fair value, the decline in the value of these investments is not considered to be "Other Than Temporary."

Maturities of debt securities classified as available-for-sale were as follows at September 30, 2015 and December 31, 2014:

	September 30, 2015		December 31, 2014	
	Amortized cost (\$ in thousands)	Fair value	Amortized cost	Fair value
<b>Available-for-sale:</b>				
Due one year or less	\$—	\$—	\$—	\$—
Due after one year through five years	—	—	—	—
Due after five years through ten years	11,037	10,797	46,870	46,881
Due after ten years through fifteen years	88,473	83,531	—	—
<b>Total</b>	<b>\$99,510</b>	<b>\$94,328</b>	<b>\$46,870</b>	<b>\$46,881</b>

Actual maturities of debt securities may differ from those presented above since certain obligations amortize and provide the issuer of the individual debt securities the right to call or prepay the obligation prior to the scheduled final stated maturity without penalty.

#### Note 6. Borrowings

##### Credit Facilities

As of September 30, 2015 the Company had five credit facilities through certain of its wholly owned subsidiaries: (i) a \$475 million credit facility with syndicated lenders agented by Wells Fargo Bank, National Association ("Wells Fargo") to fund leveraged finance loans, (ii) a \$250 million credit facility with Citibank, N.A. ("Citibank") to fund leveraged finance loans, (iii) a \$175 million credit facility with a syndicate of lenders agented by DZ Bank AG Deutsche Zentral-Genossenschaftsbank Frankfurt ("DZ Bank") to fund asset-based loans, (iv) a \$165 million credit facility with a syndicate of lenders agented by Wells Fargo to fund asset-based loans, and (v) a \$75 million credit facility with Wells Fargo to fund equipment leases and loans.

The Company must comply with various covenants under these facilities. The breach of certain of these covenants could result in a termination event and the exercise of remedies if not cured. At September 30, 2015, the Company was in compliance with all such covenants. These covenants are customary and vary depending on the type of facility. These covenants include, but are not limited to, failure to service debt obligations, failure to meet liquidity covenants and tangible net worth covenants, and failure to remain within prescribed facility portfolio delinquency, charge-off levels, and overcollateralization tests. In addition, the Company is required to make termination or make whole

payments in the event that certain of its existing credit facilities are prepaid. These termination or make-whole payments, if triggered, could be material to the Company individually or in the aggregate, and in the case of certain facilities, could be caused by factors outside of the Company's control, including as a result of loan prepayment by the borrowers under the loan facilities that collateralize these credit facilities.

The Company has a \$475.0 million credit facility with syndicated lenders agented by Wells Fargo to fund leveraged finance loans. The credit facility had an outstanding balance of \$216.1 million and unamortized deferred financing fees of \$6.9 million as of September 30, 2015. On August 10, 2015, the Company entered into an amendment to this facility which, among other thing, increased the commitment amount to \$475.0 million and extended the maturity date to August 10, 2020. Interest on this facility accrues at a variable rate per annum. The facility provides for a revolving reinvestment period which ends on August 10, 2018 with a two-year amortization period.

The Company has a \$250.0 million credit facility with Citibank to fund leveraged finance loans. The credit facility had an outstanding balance of \$208.0 million and unamortized deferred financing fees of \$1.7 million as of September 30, 2015. Interest on this facility accrues at a variable rate per annum. The facility provides for a revolving reinvestment period which ends on May 5, 2018, with a two-year amortization period.

The Company has a \$175.0 million credit facility with syndicated lenders agented by DZ Bank that had an outstanding balance of \$104.0 million and unamortized deferred financing fees of \$1.3 million as of September 30, 2015. On June 19, 2015, the Company entered into an amendment to this facility which, among other things, increased the commitment amount to \$175.0 million and extended the maturity date to June 30, 2018. Interest on this facility accrues at a variable rate per annum. As part of the agreement, there is a minimum interest charge of \$2.5 million per annum. If the facility is not utilized to cover this minimum requirement, then a

make-whole fee is assessed to satisfy the minimum requirement. The Company is permitted to use the proceeds of borrowings under the credit facility to fund advances under asset-based loan commitments. The commitment amount under the credit facility provides for reinvestment until it matures on June 30, 2018 with no amortization period.

The Company has a \$165.0 million credit facility with syndicated lenders agented by Wells Fargo to fund asset-based loan origination. The credit facility had an outstanding balance of \$97.5 million and unamortized deferred financing fees of \$0.9 million as of September 30, 2015. On June 19, 2015, the Company entered into an amendment to this facility which, among other things, increased the commitment amount to \$165.0 million. The credit facility may be increased to an amount up to \$300.0 million subject to lender approval and other customary conditions. Interest on this facility accrues at a variable rate per annum. The credit facility provides for reinvestment until it matures on December 7, 2017 with no amortization period.

The Company has a note purchase agreement with Wells Fargo under the terms of which Wells Fargo agreed to provide a \$75.0 million credit facility to fund equipment leases and loans. The credit facility had no outstanding balance and unamortized deferred financing fees of \$1.0 million as of September 30, 2015. Interest on this facility accrues at a variable rate per annum. On April 10, 2015, the Company entered into an amendment to this facility which, among other things, extended the reinvestment period to April 10, 2017 and the final maturity date to April 10, 2019, and modified certain concentration amounts and specified threshold amounts.

#### Senior notes

On April 22, 2015, the Company completed its offering of senior notes consisting of \$300.0 million aggregate principal amount of its 7.25% Senior Notes due 2020 (the "2020 Notes"). The Company subsequently repaid in full its corporate credit facility with Fortress Credit Corp. with a portion of the net proceeds from this offering. The 2020 Notes mature on May 1, 2020, and bear interest at a rate of 7.25% per annum, which is payable semi-annually on May 1 and November 1 of each year, beginning November 1, 2015. At any time prior to May 1, 2017, the Company may redeem up to 35% of the aggregate principal amount of the 2020 Notes with the net cash proceeds of certain public equity offerings at a price equal to 107.25% of the aggregate principal amount so redeemed, plus accrued and unpaid interest thereon provided that immediately following the redemption, at least 65% of the 2020 Notes that were originally issued remain outstanding and any such redemption occurs within 180 days following the closing of any such public equity offering. Additionally, at any time prior to May 1, 2017, the Company may redeem some or all of the 2020 Notes at a price equal to 100% of the aggregate principal amount, plus accrued and unpaid interest thereon and a make-whole premium. On or after May 1, 2017, the Company may redeem the 2020 Notes, in whole or in part, at redemption prices specified in the 2020 Notes plus accrued and unpaid interest thereon. In addition, if the Company undergoes a change of control, the Company will be required to make an offer to purchase each holder's 2020 Notes at a price equal to 101% of the principal amount of the 2020 Notes, plus accrued and unpaid interest. As of September 30, 2015 unamortized deferred financing fees were \$6.2 million.

#### Subordinated notes

On December 4, 2014, the Company completed the initial closing of an investment of long-term capital from funds sponsored by Franklin Square Capital Partners ("Franklin Square") and sub-advised by GSO Capital Partners. The Franklin Square funds purchased \$200.0 million of 10-year subordinated notes (the "Subordinated Notes") that rank junior to the Company's existing and future senior debt, during the three months ended September 30, 2015, the Company has drawn an additional \$50 million under these subordinated notes. The Company is required to borrow the remaining \$50.0 million of notes in increments \$25.0 million by December 4, 2015. The Subordinated Notes were recorded at par less the initial relative fair value of the warrants issued in connection with the investment on December 4, 2014 and January 23, 2015 (see Note 8) which was \$43.2 million as of December 31, 2014 and \$60.1 million as of September 30, 2015. The debt discount will amortize over the life of the notes and will be recorded as non-cash interest expense as the Subordinated Notes accrete to par value. As of September 30, 2015, unamortized deferred financing fees were \$5.7 million. The Subordinated Notes bear interest at 8.25% and include a Payment-in-Kind ("PIK



Toggle") feature that allows the Company, at its option, to elect to have interest accrued at a rate of 8.75% added to the principal of the Subordinated Notes instead of paying it in cash. The Subordinated Notes have a ten year term and mature on December 4, 2024. They are callable during the first three years with payment of a make-whole premium. The prepayment premium decreases to 103% and 101% after the third and fourth anniversaries of the closing, respectively. They are callable at par after December 4, 2019. The Subordinated Notes require a mandatory payment at the end of each accrual period, beginning on December 5, 2019. The Company is required to make a cash payment of principal plus accrued interest in an amount required to prevent the Subordinated Notes from being treated as an "Applicable High Yield Discount Obligation" within the meaning of Section 163(i)(1) of the Internal Revenue Code of 1986, as amended. Events of default under the Subordinated Notes include failure to pay interest or principal when due subject to applicable grace periods, material uncured breaches of the terms of the Subordinated Notes, and bankruptcy/insolvency events.

#### Term Debt Securitizations

In June 2007, the Company completed a term debt securitization transaction. In conjunction with this transaction the Company established a separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Trust 2007-1 (the "2007-1 CLO Trust") and sold and contributed \$600.0 million in loans and investments (including unfunded commitments), or portions thereof, to

the 2007-1 CLO Trust. The Company remains the servicer of the loans. Simultaneously with the initial sale and contribution, the 2007-1 CLO Trust issued \$546.0 million of notes to institutional investors. The Company retained \$54.0 million, comprising 100% of the 2007-1 CLO Trust's trust certificates. At September 30, 2015, the \$185.3 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$239.3 million. The 2007-1 CLO Trust permitted reinvestment of collateral principal repayments for a six-year period which ended in May 2013. During 2012, the Company purchased \$0.2 million of the 2007-1 CLO Trust's Class C notes. During 2010, the Company purchased \$5.0 million of the 2007-1 CLO Trust's Class D notes. During 2009, the Company purchased \$1.0 million of the 2007-1 CLO Trust's Class D notes.

The Company receives a loan collateral management fee and excess interest spread. The Company also receives payments with respect to the classes of notes it owns in accordance with the transaction documents. The Company expects to receive a principal distribution as owner of the trust certificates when the term debt is retired. If loan collateral in the 2007-1 CLO Trust is in default under the terms of the indenture, the excess interest spread from the 2007-1 CLO Trust would not be distributed until the undistributed cash plus recoveries equals the outstanding balance of the defaulted loan or if the Company elected to remove the defaulted collateral.

The following table sets forth selected information with respect to the 2007-1 CLO Trust:

Notes	Outstanding			Ratings (S&P/Moody's/ Fitch)(1)
	originally issued (\$ in thousands)	balance September 30, 2015	Interest rate	
<b>2007-1 CLO Trust</b>				
Class A-1	\$336,500	\$ 62,346	Libor+0.24%	September 30, 2022 AAA/Aaa/AAA
Class A-2	100,000	19,612	Libor+0.26%	September 30, 2022 AAA/Aaa/AAA
Class B	24,000	24,000	Libor+0.55%	September 30, 2022 AA+/Aa1/AA
Class C	58,500	58,293	Libor+1.30%	September 30, 2022 A-/A2/A
Class D	27,000	21,000	Libor+2.30%	September 30, 2022 BBB-/Baa2/BBB+
	\$546,000	\$ 185,251		

(1) These ratings were initially given in June 2007, are unaudited and are subject to change from time to time. On December 18, 2012, the Company completed a term debt securitization transaction. In conjunction with this transaction the Company established a separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2012-2 LLC (the "2012-2 CLO") and sold and contributed \$325.9 million in loans and investments (including unfunded commitments), or portions thereof, to the 2012-2 CLO. The Company remains the servicer of the loans. Simultaneously with the initial sale and contribution, the 2012-2 CLO issued \$263.3 million of notes to institutional investors. The Company retained \$62.6 million, comprising 100% of the 2012-2 CLO's membership interests, Class E notes, Class F notes, and subordinated notes. On June 12, 2015, the Company sold 100% of the 2012-2 CLO's Class E Notes totaling \$16.3 million to institutional investors. At September 30, 2015, the \$279.6 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$325.9 million. At September 30, 2015, deferred financing fees were \$1.6 million. The 2012-2 CLO permits reinvestment of collateral principal repayments for a three-year period ending in January 2016. Should the Company determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed

timeframe, such funds may be used to repay the outstanding notes.

The Company receives a loan collateral management fee and excess interest spread. The Company also receives payments with respect to the classes of notes it owns in accordance with the transaction documents. The Company expects to receive a principal distribution as owner of the membership interests when the term debt is retired. If loan collateral in the 2012-2 CLO is in default under the terms of the indenture, the excess interest spread from the 2012-2 CLO may not be distributed if the overcollateralization ratio, or other collateral quality tests, are not satisfied.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

The following table sets forth selected information with respect to the 2012-2 CLO:

	Notes	Outstanding balance	Interest	Legal final	Ratings
	originally	September	rate	maturity	(Moody's/ S&P)(1)
	issued	30, 2015			
	(\$ in thousands)				
<b>2012-2 CLO</b>					
Class A	\$ 190,700	\$ 190,700	Libor+1.90%	January 20, 2023	Aaa/AAA
Class B	26,000	26,000	Libor+3.25%	January 20, 2023	Aa2/N/A
Class C	35,200	35,200	Libor+4.25%	January 20, 2023	A2/N/A
Class D	11,400	11,400	Libor+6.25%	January 20, 2023	Baa2/N/A
Class E	16,300	16,300	Libor+6.75%	January 20, 2023	Ba1/N/A
	\$279,600	\$ 279,600			

(1) These ratings were initially given in December 2012, are unaudited and are subject to change from time to time. On September 11, 2013, the Company completed a term debt securitization transaction through its separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2013-1 LLC (the "2013-1 CLO") and sold and contributed \$247.6 million in loans and investments (including unfunded commitments), or portions thereof, to the 2013-1 CLO. The Company remains the servicer of the loans. Simultaneously with the initial sale and contribution, the 2013-1 CLO issued \$338.6 million of notes to institutional investors. The Company retained \$61.4 million, comprising 100% of the 2013-1 CLO's membership interests, Class F notes, Class G notes, and subordinated notes. At September 30, 2015, the \$334.6 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$396.0 million. At September 30, 2015, deferred financing fees were \$3.8 million. The 2013-1 CLO permits reinvestment of collateral principal repayments for a three-year period ending in September 2016. Should the Company determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes.

The Company receives a loan collateral management fee and excess interest spread. The Company also receives payments with respect to the classes of notes it owns in accordance with the transaction documents. The Company expects to receive a principal distribution as owner of the membership interests when the term debt is retired. If loan collateral in the 2013-1 CLO is in default under the terms of the indenture, the excess interest spread from the 2013-1 CLO may not be distributed if the overcollateralization ratio, or other collateral quality tests, are not satisfied.

The following table sets forth selected information with respect to the 2013-1 CLO:

	Notes	Outstanding balance	Interest	Legal final	Ratings
	originally	September	rate	maturity	(S&P/ Moody's)(2)
	issued	30, 2015			
	(\$ in thousands)				

2013-1 CLO					
Class A-T	\$ 202,600	\$ 202,600	Libor+1.65%	September 20, 2023	AAA/Aaa
Class A-R	35,000	31,000	(1)	September 20, 2023	AAA/Aaa
Class B	38,000	38,000	Libor+2.30%	September 20, 2023	AA/N/A
Class C	36,000	36,000	Libor+3.80%	September 20, 2023	A/N/A
Class D	21,000	21,000	Libor+4.55%	September 20, 2023	BBB/N/A
Class E	6,000	6,000	Libor+5.30%	September 20, 2023	BBB-/N/A
	\$ 338,600	\$ 334,600			

(1) Class A-R Notes accrue interest at the Class A-R CP Rate so long as they are held by a CP Conduit, and otherwise will accrue interest at the Class A-R LIBOR Rate or, in certain circumstances, the Class A-R Base Rate, but in no event shall interest rate payable pari passu with the Class A-T Notes exceed the Class A-R Waterfall Rate Cap.

(2) These ratings were initially given in September 2013, are unaudited and are subject to change from time to time. On April 17, 2014, the Company completed a term debt securitization transaction through its separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2014-1 LLC (the "2014-1 CLO") and sold and contributed \$249.6 million in loans and investments (including unfunded commitments), or portions thereof, to the 2014-1 CLO. The Company remains the servicer of the loans. Simultaneously with the initial sale and contribution, the 2014-1 CLO issued \$289.5 million of notes to institutional investors. The Company retained \$58.9 million, comprising 100% of the 2014-1 CLO's membership interests, Class E

notes, Class F notes, and subordinated notes. At September 30, 2015, the \$289.5 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$348.4 million. At September 30, 2015, deferred financing fees were \$2.7 million. The 2014-1 CLO permits reinvestment of collateral principal repayments for a four-year period ending in April 2018. Should the Company determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes.

The Company receives a loan collateral management fee and excess interest spread. The Company also receives payments with respect to the classes of notes it owns in accordance with the transaction documents. The Company expects to receive a principal distribution as owner of the membership interests when the term debt is retired. If loan collateral in the 2014-1 CLO is in default under the terms of the indenture, the excess interest spread from the 2014-1 CLO may not be distributed if the overcollateralization ratio, or other collateral quality tests, are not satisfied.

The following table sets forth selected information with respect to the 2014-1 CLO:

Notes	Outstanding		Interest	Legal final	Ratings
	originally	balance			
issued	September	rate	maturity	(Moody's)(2)	
(\$ in thousands)					
<b>2014-1 CLO</b>					
Class A	\$202,500	\$ 202,500	Libor+1.80%	April 20, 2025	Aaa
Class B-1	20,000	20,000	Libor+2.60%	April 20, 2025	Aa2
Class B-2	13,250	13,250	(1)	April 20, 2025	Aa2
Class C	30,250	30,250	Libor+3.60%	April 20, 2025	A2
Class D	23,500	23,500	Libor+4.75%	April 20, 2025	Baa3
	\$289,500	\$ 289,500			

(1)Class B-2 Notes accrue interest at a fixed rate of 4.902%.

(2)These ratings were initially given in April 2014, are unaudited and are subject to change from time to time. On March 20, 2015, the Company completed a term debt securitization transaction through its separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2015-1 LLC (the "2015-1 CLO") and sold and contributed \$336.3 million in loans and investments (including unfunded commitments), or portions thereof, to the 2015-1 CLO. The Company remains the servicer of the loans. Simultaneously with the initial sale and contribution, the 2015-1 CLO issued \$410.3 million of notes to institutional investors. The Company retained \$85.8 million, comprising 100% of the 2015-1 CLO's membership interests and subordinated notes. At September 30, 2015, the \$410.3 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$496.1 million. At September 30, 2015, deferred financing fees were \$4.1 million. The 2015-1 CLO permits reinvestment of collateral principal repayments for a four-year period ending in April 2019. Should the Company determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes.

The Company receives a loan collateral management fee and excess interest spread. The Company also receives payments with respect to the classes of notes it owns in accordance with the transaction documents. The Company

expects to receive a principal distribution as owner of the membership interests when the term debt is retired. If loan collateral in the 2015-1 CLO is in default under the terms of the indenture, the excess interest spread from the 2015-1 CLO may not be distributed if the overcollateralization ratio, or other collateral quality tests, are not satisfied.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

The following table sets forth selected information with respect to the 2015-1 CLO:

	Notes	Outstanding balance	Interest	Legal final	Ratings
	originally issued	September 30, 2015	rate	maturity	(Moody's/Fitch)(2)
(\$ in thousands)					
<b>2015-1 CLO</b>					
Class A-1	\$253,500	\$ 253,500	Libor+1.80%	January 20, 2027	Aaa/AAA
Class A-2	35,000	35,000	(1)	January 20, 2027	Aaa/AAA
Class B	50,000	50,000	Libor+2.80%	January 20, 2027	Aa2/ N/A
Class C	38,500	38,500	Libor+3.85%	January 20, 2027	A2/N/A
Class D	33,250	33,250	Libor+5.50%	January 20, 2027	Baa3/N/A
	\$410,250	\$ 410,250			

(1) Class A-2 Notes accrue interest at a spread over Libor of 1.65% from the closing date to, but excluding March 20, 2017, and 2.00% thereafter.

(2) These ratings were initially given in March 2015, are unaudited and are subject to change from time to time. On September 1, 2015, NewStar Equipment Finance I, LLC, a subsidiary of the Company, completed a static asset-backed securitization transaction through its separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Lease Funding 2015-1 LLC (the "2015-1 ABS") and sold and contributed \$100.1 million in leases and equipment loans (including unfunded commitments), or portions thereof, to the 2015-1 ABS. The Company remains the servicer of the leases and equipment loans. Simultaneously with the initial sale and contribution, the 2015-1 ABS issued \$70.0 million of notes to institutional investors. The Company retained all of the 2015-1 ABS's membership interest and the Class B notes, totaling \$40.6 million. At September 30, 2015, the \$64.0 million of outstanding drawn notes were secured by cash, leases and equipment loans totaling \$104.6 million. At September 30, 2015, deferred financing fees were \$1.3 million.

The Company receives a collateral management fee and excess interest spread. The Company also receives payments with respect to the classes of notes it owns in accordance with the transaction documents. The Company expects to receive a principal distribution as owner of the membership interests when the term debt is retired. If loan collateral in the 2015-1 ABS is in default under the terms of the indenture, the excess interest spread may not be distributed if the target overcollateralization ratio, or other performance based tests, are not satisfied.

The following table sets forth selected information with respect to the 2015-1 ABS:

	Notes	Outstanding balance	Interest	Legal final	Ratings
	originally issued	September 30, 2015	rate	maturity	(DBRS)(1)



Edgar Filing: NewStar Financial, Inc. - Form 10-Q

(\$ in thousands)

2015-1 ABS					
Class A	\$70,046	63,993	3.27%	April 15, 2019	AA
	\$70,046	\$ 63,993			

(1) These ratings were initially given in September 2015, are unaudited and are subject to change from time to time.

On September 15, 2015, the Company completed a term debt securitization transaction through its separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2015-2 LLC (the “2015-2 CLO”) and sold and contributed \$298.4 million in loans and investments (including unfunded commitments), or portions thereof, to the 2015-2 CLO. The Company remains the servicer of the loans. Simultaneously with the initial sale and contribution, the 2015-2 CLO issued \$327.8 million of notes to institutional investors. The Company retained \$70.1 million, comprising 100% of the 2015-2 CLO’s membership interests and a portion of the Class E notes. At September 30, 2015, the \$327.8 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$397.8 million. At September 30, 2015, deferred financing fees were \$4.1 million. The 2015-2 CLO permits reinvestment of collateral principal repayments for a four-year period ending in August 2019. Should the Company determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

The Company receives a loan collateral management fee and excess interest spread. The Company also receives payments with respect to the classes of notes it owns in accordance with the transaction documents. The Company expects to receive a principal distribution as owner of the membership interests when the term debt is retired. If loan collateral in the 2015-2 CLO is in default under the terms of the indenture, the excess interest spread from the 2015-2 CLO may not be distributed if the overcollateralization ratio, or other collateral quality tests, are not satisfied.

The following table sets forth selected information with respect to the 2015-2 CLO:

Notes	Outstanding		Interest	Legal final	Ratings
	originally	balance			
issued	September	rate	maturity	(Moody's/Fitch)(2)	
(\$ in thousands)					
<b>2015-2 CLO</b>					
Class A-1	\$ 205,000	\$ 205,000	Libor+2.00%	August 25, 2027	Aaa/AAA
Class A-2	23,000	23,000	(1)	August 25, 2027	Aaa/AAA
Class B	40,000	40,000	Libor+2.90%	August 25, 2027	Aa2/ N/A
Class C	26,250	26,250	Libor+3.95%	August 25, 2027	A2/N/A
Class D	28,500	28,500	Libor+5.25%	August 25, 2027	Baa3/N/A
Class E	5,000	5,000	Libor+7.50%	August 25, 2027	Ba3/N/A
	\$ 327,750	\$ 327,750			

(1)Class A-2 Notes accrue interest at a fixed rate of 3.461%.

(2)These ratings were initially given in August 2015, are unaudited and are subject to change from time to time.

#### Corporate Credit Facility

On January 5, 2010, the Company entered into a note agreement with Fortress Credit Corp., which was subsequently amended on August 31, 2010, January 27, 2012, November 5, 2012, and December 4, 2012. The agreement was amended and restated on May 13, 2013 and further amended on June 3, 2013. The credit facility, as amended, consisted of a \$238.5 million term note with Fortress Credit Corp. as agent, which consisted of the existing outstanding balance of \$100.0 million (the "Existing Funding"), an initial funding of \$98.5 million (the "Initial Funding"), and three subsequent borrowings, of \$5.0 million (the "Delay Draw Term A"), \$25.0 million (the "Delay Draw Term B") and the \$10.0 million Term C Loan. On April 22, 2015, the Company repaid in full the term note with Fortress Credit Corp.

#### Note 7. Repurchase Agreements

Loans sold under agreements to repurchase

Year Ended

	Three Months Ended September 30, 2015	December 31, 2014		
	(\$ in thousands)			
Outstanding at end of period	\$137,640	\$	57,227	
Weighted average rate at end of period	3.56	%	5.16	%

On June 7, 2011, the Company entered into a five-year, \$68.0 million financing arrangement with Macquarie Bank Limited backed primarily by a portfolio of commercial mortgage loans previously originated by the Company. The financing was structured as a master repurchase agreement under which the Company sold the portfolio of commercial mortgage loans to Macquarie for an aggregate purchase price of \$68.0 million. The Company also agreed to repurchase the commercial mortgage loans from time to time (including a minimum quarterly amount), and agreed to repurchase all of the commercial mortgage loans by June 7, 2016. Upon the repurchase of a commercial mortgage loan, the Company is obligated to repay the principal amount related to such mortgage loan plus accrued interest (at a rate based on LIBOR plus a margin) to the date of repurchase. The Company will continue to service the commercial mortgage loans. On October 2, 2013, the Company entered into an amendment to this financing arrangement which, among other things, extended the date it had agreed to repurchase all of the commercial mortgage loans by one year to June 7, 2017, provided for \$25.5 million of additional advances for existing eligible assets owned by the Company, allowed for the advance of up to \$15.0 million to fund an additional commercial mortgage loan, and released \$41.1 million of principal payments to the Company as unrestricted cash. The facility accrues interest at a variable rate per annum, which was 5.21% as of September 30, 2015. As of September 30, 2015, unamortized deferred financing fees were \$0.6 million and the outstanding balance was \$42.4 million. During 2015, the Company made principal payments totaling \$14.8 million.

The Company has entered into a repurchase transaction with Deutsche Bank AG, pursuant to the terms of a Global Master Repurchase Agreement (2000 version), dated as of February 13, 2015 between Deutsche Bank AG and NS Bond Funding I LLC (the “Deutsche Bank Repurchase Agreement”). Pursuant to the Deutsche Bank Repurchase Agreement, Deutsche Bank AG will purchase securities and simultaneously agree to sell the securities back to the Company at a specified date. Under the terms of the Deutsche Bank Repurchase Agreement, the Company is required at all times to maintain a level of overcollateralization for the obligations, which is maintained through daily margining. As of September 30, 2015, the outstanding balance was \$12.2 million. The Company has made certain representations and warranties and is required to comply with various covenants and requirements customary for financing arrangements of this nature.

The Company has entered into a repurchase transaction with Citigroup Global Markets, pursuant to the terms of a Global Master Repurchase Agreement (2000 version), dated as of March 16, 2015 between Citigroup Global Markets and NS Loan Originator LLC (the “Citigroup Repurchase Agreement”). Pursuant to the Citigroup Repurchase Agreement, Citigroup Global Markets will purchase securities and simultaneously agree to sell the securities back to the Company at a specified date. Under the terms of the Citigroup Repurchase Agreement, the Company is required at all times to maintain a level of overcollateralization for the obligations, which is maintained through daily margining. As of September 30, 2015, the outstanding balance was \$15.2 million. The Company has made certain representations and warranties and is required to comply with various covenants and requirements customary for financing arrangements of this nature.

The Company has entered into a repurchase transaction with JP Morgan Chase Bank pursuant to the terms of a Global Master Repurchase Agreement (2000 version), dated as of April 2, 2015 between JP Morgan Chase Bank and NS Bond Funding II LLC (the “JP Morgan Repurchase Agreement”). Pursuant to the JP Morgan Repurchase Agreement, JP Morgan Chase Bank will purchase securities and simultaneously agree to sell the securities back to the Company at a specified date. Under the terms of the JP Morgan Repurchase Agreement, the Company is required at all times to maintain a level of overcollateralization for the obligations, which is maintained through daily margining. As of September 30, 2015, the outstanding balance was \$67.8 million. The Company has made certain representations and warranties and is required to comply with various covenants and requirements customary for financing arrangements of this nature.

#### Note 8. Stockholders’ Equity

##### Stockholders’ Equity

As of September 30, 2015 and December 31, 2014, the Company’s authorized capital consists of preferred and common stock and the following was authorized and outstanding:

	September 30, 2015		December 31, 2014	
	Shares	Shares	Shares	Shares
	authorized outstanding		authorized outstanding	
	(In thousands)			
Preferred stock	5,000	—	5,000	—
Common stock	145,000	45,847	145,000	46,620

### Preferred Stock

Since the completion of the Company's initial public offering on December 13, 2006, the Company's authorized capital stock has included 5,000,000 shares of preferred stock with a par value of \$0.01 per share, all of which remain undesignated.

### Common Stock

On March 24, 2015, the Company repurchased 1,000,000 shares of its common stock in a privately negotiated transaction with an unaffiliated third party for an aggregate purchase price of \$10.3 million.

On December 22, 2014, the Company repurchased 1,000,000 shares of its common stock in a privately negotiated transaction with an unaffiliated third party for an aggregate purchase price of \$10.2 million.

On August 13, 2014, the Company's Board of Directors authorized the repurchase of up to \$10.0 million of the Company's common stock from time to time on the open market or in privately negotiated transactions. The timing and amount of any shares purchased are determined by the Company's management based on its evaluation of market conditions and other factors. The Company completed the repurchase program during July 2015. As of September 30, 2015, the Company had repurchased 892,911 shares of its common stock under this program at a weighted average price per share of \$11.20.

On May 5, 2014, the Company's Board of Directors authorized the repurchase of up to \$20.0 million of the Company's common stock from time to time on the open market or in privately negotiated transactions. The timing and amount of any shares purchased were determined by the Company's management based on its evaluation of market conditions and other factors. The Company completed repurchase program during July 2014. Under this stock repurchase program, the Company repurchased 1,519,615 shares of its common stock at a weighted average price per share of \$13.13 in the aggregate.

#### Warrants

On December 4, 2014, the Company issued warrants to purchase 9.5 million shares of its common stock as part of the strategic relationship with Franklin Square Capital Partners ("Franklin Square"). Each warrant allows the warrant holder to purchase one share of the Company's common stock at a purchase price equal to \$12.62 per share. The warrants were deemed to be freestanding and indexed to the Company's common stock. As such they were recorded at relative fair value, with no required subsequent re-measurement. The warrants expire on December 4, 2024.

On January 23, 2015, the Company completed its issuance of warrants as part of the strategic relationship with Franklin Square. The Company issued the second tranche of warrants to purchase 2.5 million shares of its common stock subject to the same terms as the warrants that were issued on December 4, 2014.

#### Restricted Stock

During the nine months ended September 30, 2015, the Company issued 355,876 shares of restricted stock to certain employees of the Company pursuant to the Company's 2006 Incentive Plan, as amended and 51,352 shares of restricted stock to non-employee members of the Board of Directors. The fair value of the shares of restricted stock is equal to the closing price of the Company's stock on the date of issuance. The shares of restricted stock issued to employees of the Company vest in three equal installments on each of the first three anniversaries of the date of grant. The shares of restricted stock issued to non-employee members of the Board of Directors vest on the first anniversary of the date of grant.

Restricted stock activity for the nine months ended September 30, 2015 was as follows:

	Shares	Grant-date fair value (\$ in thousands)
Non-vested as of December 31, 2014	315,338	\$ 4,091
Granted	407,228	4,322
Vested	(218,999)	(2,700 )
Forfeited	(2,213 )	(27 )
Non-vested as of September 30, 2015	501,354	\$ 5,686

The Company's compensation expense related to restricted stock was \$0.8 million and \$2.5 million, respectively, for the three and nine months ended September 30, 2015 and \$0.6 million and \$1.8 million, respectively, for the three and nine months ended September 30, 2014. The unrecognized compensation cost of \$3.1 million at September 30, 2015 is expected to be recognized over the next three years.

#### Stock Options

Under the Company's 2006 Incentive Plan, the Company's compensation committee may grant options to purchase shares of common stock. Stock options may either be incentive stock options ("ISOs") or non-qualified stock options. ISOs may only be granted to officers and employees. The compensation committee will, with regard to each stock option, determine the number of shares subject to the stock option, the manner and time of exercise, vesting, and the exercise price, which will not be less than 100% of the fair market value of the common stock on the date of the grant. The shares of common stock issuable upon exercise of options or other awards or upon grant of any other award may be either previously authorized but unissued shares or treasury shares.

Stock option activity for the nine months ended September 30, 2015 was as follows:

	Options
Outstanding as of December 31, 2014	4,628,439
Granted	—
Exercised	(384,332 )
Forfeited	(17,815 )
Outstanding as of September 30, 2015	4,226,292
Vested as of September 30, 2015	4,226,292
Exercisable as of September 30, 2015	4,226,292

As of September 30, 2015 and December 31, 2014, the Company has recognized all compensation costs related to options granted.

#### Note 9. Earnings Per Share

The Company utilizes the two-class method to calculate earnings per share. The two-class method allocates net income to each class of common stock and participating security. Unvested share-based payment awards granted to certain employees and board members entitle holders to same rights as outstanding and vested common stock. These securities are considered to be participating securities and are included in the allocation for computing earnings per share under this method. Income is allocated to common shareholders and participating securities under the two-class method based upon the proportion of each to the total weighted average shares available.

The computations of basic and diluted income per share for the three and nine months ended September 30, 2015 and 2014 are as follows:

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2014	
	2015	2014	2015	2014
	(In thousands)			
<b>Numerator:</b>				
Net income to common shareholders	\$5,142	\$5,020	\$12,681	\$9,368
Net income allocated to participating securities - basic and diluted	57	33	137	65
Net income allocated to common shareholders - basic and diluted	5,085	4,987	12,544	9,303
<b>Denominator:</b>				
Denominator for basic earnings per common share	45,745	47,900	46,139	48,501
<b>Denominator for diluted earnings per common share:</b>				
Denominator for basic earnings per common share	45,745	47,900	46,139	48,501
Potentially dilutive securities - options	2,494	2,903	2,566	3,278



Edgar Filing: NewStar Financial, Inc. - Form 10-Q

Potentially dilutive securities – restricted stock	—	—	—	—
Potentially dilutive securities - warrants	—	—	—	118
Total weighted average diluted shares	48,239	50,803	48,705	51,897
Earnings per common share				
Basic	\$0.11	\$0.10	\$0.27	\$0.19
Diluted	\$0.11	\$0.10	\$0.26	\$0.18

Warrants to purchase common stock totaling 12,000,000 were not included in the computation of earnings per share for the three and nine months ended September 30, 2015 due to the fact that the results would be anti-dilutive.

Note 10. Variable Interest Entities

The Company sponsors the formation of various entities that are considered to be VIEs. The Company evaluates the need to consolidate these entities pursuant to Accounting Standards Codification ("ASC") Topic 810 relating to the consolidation of VIEs. These VIEs were formed to issue term debt securitizations. The assets of the VIEs are primarily comprised of senior secured loans and the liabilities are primarily comprised of debt. The Company's determination of whether it is the primary beneficiary of the VIE is based in part on an assessment of whether or not the Company is exposed to the majority of the risks and rewards of the entity. In instances where the Company retains a significant portion of the equity and remains the servicer of the loans, it was determined that

the Company has the power to direct the activities that most significantly impact the economic performance of these VIEs. Additionally, the Company determined that the potential fees that they could receive directly or indirectly from these VIEs represent rights to returns that could potentially be significant to the VIEs. As a result, the Company was deemed the primary beneficiary and therefore has consolidated these entities. VIEs that have been consolidated are disclosed in Note 6.

The Company's involvement with term debt securitizations that are VIEs and unconsolidated by the Company is generally limited to that of an investment manager and its investment in the unconsolidated VIE, if any. The Company is not the primary beneficiary of these unconsolidated VIEs. The Company's investment in any unconsolidated VIE generally represent an insignificant equity interest. The Company's exposure to the risk in these entities is generally limited to any capital contributions it has made or is required to make and any earned but uncollected management fees.

The following table sets forth the information with respect to the unconsolidated VIEs for which the Company holds a variable interest in as of September 30, 2015 and December 31, 2014:

	September 30, 2015	December 31, 2014
	(\$ in thousands)	
Unconsolidated VIE assets	\$807,370	\$ 400,000
Unconsolidated VIE liabilities	729,046	368,750
Equity interest included on the Consolidated Balance Sheet	—	—
Maximum risk of loss (1)	24,566	1,047

(1)Includes equity investment the Company has made, or is required to make, and any earned but uncollected management and incentive fees. The Company does not record performance and incentive allocations until the respective measurement period has ended.

In April 2013, the Company formed a new managed credit fund, NewStar Arlington Fund LLC ("Arlington Fund") in partnership with an institutional investor to co-invest in middle market commercial loans originated by the Company's Leveraged Finance group. As the managing member of Arlington Fund, the Company retained full discretion over Arlington Fund's investment decisions, subject to usual and customary limitations, and earned management fees as compensation for its services. For the nine months ended September 30, 2014, the management fee was \$0.5 million which was eliminated in consolidation.

On April 4, 2013, Arlington Fund entered into an agreement establishing \$147.0 million of Class A variable funding notes (the "Class A Notes") and \$28.0 million of Class B variable funding notes (the "Class B Notes") to partially fund eligible middle market loan origination for Arlington Fund. Wells Fargo Bank, National Association funded the Class A Notes as the initial Class A lender and the Company funded the Class B Notes as the initial Class B lender. For the nine months ended September 30, 2014 interest expense on the Class B Notes totaled \$0.7 million. For the nine months ended September 30, 2014 and for the year ended December 31, 2013 the Fund distributed excess cash to its institutional investor totaling \$0.7 million and \$0.6 million, respectively.

From inception, the Company was deemed to be the primary beneficiary of Arlington Fund and, therefore, consolidated the financial results of Arlington Fund with the Company's results of operations and statements of financial position since April 2013.

On June 26, 2014, the NewStar Arlington Senior Loan Program LLC (the "Arlington Program") completed a \$409.4 million term debt securitization comprised of all of the Arlington Fund's loans as well as a portion of the Company's

loans classified as held-for-sale. A portion of the proceeds from this term debt securitization were used to repay all advances under the Class A Notes and the Class B Notes. Following repayment, the Class A Notes and the Class B Notes were redeemed. As a result the amortization of \$1.1 million of deferred financing fees was accelerated and recognized during the three months ended June 30, 2014. The Company's membership interests in Arlington Fund were also redeemed and new membership interests in the Arlington Program were issued to its equity investors. The Company did not recognize a gain or a loss on the redemption of its membership interests in the Arlington Fund. The Company acts as collateral manager for the Arlington Program. As a result of the repayment of the Company's advances as the Class B lender under the warehouse facility and the redemption of its membership interests in the Arlington Fund, the Company has no ownership or financial interests in the Arlington Fund or its successors except to the extent that it receives management fees as collateral manager of the Arlington Program. As a result, the Company deconsolidated the Arlington Fund from its statements of financial position beginning on June 26, 2014. The Company determined that it is not the primary beneficiary of the Arlington Program and will not consolidate the Arlington Program's operating results or statements of financial position as of that date.

Although the Company consolidated all of the assets and liabilities of Arlington Fund, during the period from April 4, 2013 through June 26, 2014, its maximum exposure to loss was limited to its investments in membership interests in Arlington Fund, its Class B Note receivable, as well as the management fee receivable from Arlington Fund. These items defined the Company's economic relationship with Arlington Fund but were eliminated upon consolidation. The Company managed the assets of Arlington Fund solely for the benefit of its lenders and investors. If the Company were to have liquidated, the assets of Arlington Fund would

not have been available to the Company's general creditors. Conversely, the investors in the debt of Arlington Fund had no recourse to the Company's general assets. Therefore, the Company did not consider this debt its obligation.

During the period from April 4, 2013 through June 26, 2014 when the Company consolidated the Arlington Fund as a variable interest entity, or VIE, the membership interests representing equity ownership of Arlington Fund were characterized as debt in the Company's consolidated statement of financial position. The Company applied an imputed interest rate to that debt and recorded the resulting interest expense in its consolidated statement of operations. In the consolidation, the Company eliminated the economic results of its related portion of the membership interests and the applied interest expense from its results of operations and statements of financial position.

#### Note 11. Financial Instruments with Off-Balance Sheet Risk

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its borrowers. These financial instruments include unfunded commitments and standby letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement we have in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Unused lines of credit are commitments to lend to a borrower if certain conditions have been met. These commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because certain commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each borrower's creditworthiness on a case-by-case basis. The amount of collateral required is based on factors that include management's credit evaluation of the borrower and the borrower's compliance with financial covenants. Due to their fluctuating nature, the Company cannot know with certainty the aggregate amounts that will be required to fund its unfunded commitments. The aggregate amount of these unfunded commitments currently exceeds the Company's available funds and will likely continue to exceed its available funds in the future.

On December 4, 2014, the Company entered into a total return swap ("TRS") for senior floating rate loans with Citibank. The TRS with Citibank enables the Company, through a wholly owned financing subsidiary NewStar TRS I LLC, to obtain the economic benefits of the loans subject to the TRS, despite the fact that such loans will not be directly owned by it, in return for an interest payment to Citibank. The Company acts as the manager of the TRS and selects the specific loans to be subject to the TRS. The TRS does not qualify for hedge accounting treatment as it does not offset the risks of another investment position. As of September 30, 2015, the fair value of the underlying loan portfolio was \$160.8 million and \$109.2 million as of December 31, 2014. Interest accrues at one-month LIBOR+1.60% per annum. At September 30, 2015 and December 31, 2014, the Company had net interest receivable from the TRS of \$1.6 million and \$0.1 million, respectively, included in "Other assets". The Company is required to cash collateralize a specified percentage of each loan included under the TRS in accordance with margin requirements. As of September 30, 2015 and December 31, 2014, the Company had cash collateral on deposit with Citibank of \$51.8 million and \$39.0 million, respectively. The Company's obligations under the TRS are non-recourse to it, and its exposure is limited to the value of the cash collateral which may fluctuate from time to time depending on the market value of the underlying loans. At September 30, 2015, the TRS had an unrealized loss position of \$1.8 million compared to an unrealized loss position of \$0.9 million at December 31, 2014 that was included in "Other

assets” and the change was recorded in “Non-interest income”. This loss is based on mark-to-market valuations of the underlying loans and is subject to period over period fluctuations; as such we may be subject to material fluctuations in our consolidated results of operations due to unrealized gains or losses. In addition, unrealized losses in the TRS or other of our off-balance sheet obligations may be realized if we are in a loss position at the time of sale or other disposition.

The credit risk involved in issuing letters of credit is essentially the same as that involved in extending credit to our borrowers. Standby letters of credit are conditional commitments issued by us to guarantee the performance by a borrower to a third party.

Financial instruments with off-balance sheet risk are summarized as follows:

	September 30,	December 31,
	2015	2014
	(\$ in thousands)	
Unused lines of credit	\$484,721	\$317,583
Standby letters of credit	8,082	7,911

Note 12. Fair Value

ASC 820, Fair Value Measurements (“ASC 820”) establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
  - Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
  - Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.
- A financial instrument’s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following table presents recorded amounts of assets and liabilities measured at fair value on a recurring and nonrecurring basis as of September 30, 2015, by caption in the consolidated balance sheet and by ASC 820 valuation hierarchy (as described above).

	Quoted Prices  in Active Markets for Identical Assets Inputs (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Carrying Value in Consolidated Balance Sheet
	(\$ in thousands)			
<b>Recurring Basis:</b>				
Investments in debt securities, available-for-sale	\$—	\$ —	\$ 94,328	\$ 94,328
TRS	—	(242 )	—	(242 )
Total assets recorded at fair value on a recurring basis	\$—	\$ (242 )	\$ 94,328	\$ 94,086
<b>Nonrecurring Basis:</b>				
Loans, net	\$—	\$ —	\$ 27,698	\$ 27,698
Loans, held-for-sale	\$—	\$ 9,910	\$ —	\$ 9,910
Total assets recorded at fair value on a nonrecurring				
basis	\$—	\$ 9,910	\$ 27,698	\$ 37,608

At September 30, 2015, “Investments in debt securities, available-for-sale” consisted of collateralized loan obligations. The fair value measurement is obtained through a third party pricing service or by using internally developed financial models.

At September 30, 2015, “Other assets” included TRS with Citibank. The TRS has a maximum notional amount of \$175.0 million and is carried at an estimated fair value of \$(0.2) million, comprised of \$1.6 million of interest receivable and an unrealized loss of \$1.8 million on the underlying loan portfolio. The fair value measurement is derived from third party pricing service.

At September 30, 2015, “Loans, net” measured at fair value on a nonrecurring basis consisted of impaired collateral-dependent commercial real estate loans. The fair values of these loans are based on third party appraisals of the underlying collateral value as well as the Company’s internal analysis. During the nine months ended September 30, 2015, the Company recorded \$0.1 million of specific allowance for credit losses related to “Loans, net” measured at fair value at September 30, 2015.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

The following table presents a summary of significant unobservable inputs and valuation techniques of the Company's Level 3 fair value measurements at September 30, 2015.

	Fair value (\$ in thousands)	Valuation Techniques	Unobservable Input	Range
<b>Financial assets:</b>				
Investments in debt securities, available-for-sale	\$94,328	Third-party pricing	Pricing assumptions such as prepayment rates, interest rates, loss assumptions, cash flow projections, and comparisons to similar financial instruments	
Loans and leases, net	27,698	Market comparables Valuation model	Cost to sell Marketability discount	3% - 7% 5%-30%
<b>Total:</b>	<b>\$122,026</b>			

The following table presents recorded amounts of assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2014, by caption in the consolidated balance sheet and by ASC 820 valuation hierarchy (as described above).

	Quoted Prices in Active Markets for Identical Inputs (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Carrying Value in Consolidated Balance Sheet
<b>Recurring Basis:</b>				
Investments in debt securities, available-for-sale	\$—	\$ —	\$ 46,881	\$ 46,881
TRS	—	(740 )	—	(740 )
Total assets recorded at fair value on a recurring basis	\$—	\$(740 )	\$ 46,881	\$ 46,141
<b>Nonrecurring Basis:</b>				
Loans, net	\$—	\$ —	\$ 27,719	\$ 27,719
Loans, held-for-sale	\$—	\$ 3,973	\$ —	\$ 3,973
Total assets recorded at fair value on a	\$—	\$ 3,973	\$ 27,719	\$ 31,692



nonrecurring basis

At December 31, 2014, “Investments in debt securities, available-for-sale” consisted of collateralized loan obligations. The fair value measurement is obtained through a third party pricing service or by using internally developed financial models.

At December 31, 2014, “Other assets” included TRS with Citibank. The TRS has a maximum notional amount of \$125.0 million and is carried at an estimated fair value of \$(0.8) million, comprised of \$0.1 million of interest receivable and an unrealized loss of \$0.9 million on the underlying loan portfolio. The fair value measurement is obtained through a third party pricing service.

At December 31, 2014, “Loans, net” measured at fair value on a nonrecurring basis consisted of impaired collateral-dependent commercial real estate loans. The fair values of these loans are based on third party appraisals of the underlying collateral value as well as the Company’s internal analysis. During 2014, the Company released \$0.1 million of specific allowance for credit losses related to “Loans, net” measured at fair value at December 31, 2014.

34

---

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

The following table presents a summary of significant unobservable inputs and valuation techniques of the Company's Level 3 fair value measurements at December 31, 2014.

	Fair value	Valuation Techniques	Unobservable Input	Range
	(\$ in thousands)			
<b>Financial assets:</b>				
Investments in debt securities,		Third-party pricing	Pricing assumptions such as prepayment rates, interest rates, loss assumptions, cash flow projections, and comparisons to similar financial instruments	
available-for-sale	\$46,881			
Loans and leases, net		Market comparables	Cost to sell Marketability discount	3% - 7%
	27,719	Valuation model		5%-30%
<b>Total:</b>	<b>\$74,600</b>			

Changes in level 3 recurring fair value measurements

The table below illustrates the change in balance sheet amounts during the three and nine months ended September 30, 2015 and 2014 (including the change in fair value), for financial instruments measured on a recurring basis and classified by the Company as level 3 in the valuation hierarchy. When a determination is made to classify a financial instrument as level 3, the determination is based upon the significance of the unobservable parameters to the overall fair value measurement. However, level 3 financial instruments typically include, in addition to the unobservable or level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources); accordingly, the gains and losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology. The Company did not transfer any financial instruments in or out of level 1, 2, or 3 during the three and nine months ended September 30, 2015 and 2014.

For the three months ended September 30, 2015:

	Investments in Debt Securities, Available-for-sale (\$ in thousands)
Balance as of June 30, 2015	\$ 108,454
Total gains or losses (realized/unrealized)	
Included in earnings	376
Included in other comprehensive income	(4,365 )
Purchases	22,863
Issuances	—
Settlements	(33,000 )
Balance as of September 30, 2015	\$ 94,328

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

For the three months ended September 30, 2014:

	Investments in Debt Securities, Available-for-sale (\$ in thousands)
Balance as of June 30, 2014	\$ 16,545
Total gains or losses (realized/unrealized)	
Included in earnings	55
Included in other comprehensive income	(186 )
Purchases	4,609
Issuances	—
Settlements	—
Balance as of September 30, 2014	\$ 21,023

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

For the nine months ended September 30, 2015:

	Investments in Debt Securities, Available-for-sale (\$ in thousands)
Balance as of December 31, 2014	\$ 46,881
Total gains or losses (realized/unrealized)	
Included in earnings	620
Included in other comprehensive income	(5,193 )
Purchases	85,020
Issuances	—
Settlements	(33,000 )
Balance as of September 30, 2015	\$ 94,328

For the nine months ended September 30, 2014:

	Investments in Debt Securities, Available-for-sale (\$ in thousands)
Balance as of December 31, 2013	\$ 22,198
Total gains or losses (realized/unrealized)	
Included in earnings	349
Included in other comprehensive income	(133 )
Purchases	4,609
Issuances	—
Settlements	(6,000 )
Balance as of September 30, 2014	\$ 21,023

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments at September 30, 2015 and December 31, 2014. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties.

September 30, 2015		December 31, 2014	
Carrying		Carrying	
amount	Fair value	amount	Fair value
(\$ in thousands)			

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

<b>Financial assets:</b>				
Cash and cash equivalents	\$57,472	\$57,472	\$33,033	\$33,033
Restricted cash	140,854	140,854	95,411	95,411
Cash collateral on deposit with custodian	53,738	53,738	38,975	38,975
Loans held-for-sale	427,418	427,418	200,569	200,569
Loans and leases, net	2,991,370	3,016,543	2,305,896	2,314,271
Investments in debt securities available-for-sale	94,328	94,328	46,881	46,881
Other assets	11,227	11,227	15,613	15,613
<b>Financial liabilities:</b>				
Credit facilities	\$625,595	\$625,595	\$487,768	\$487,768
Term debt	1,890,765	1,880,704	1,193,187	1,163,803
Repurchase agreements	137,640	142,337	57,227	63,507
Senior notes	300,000	297,930	—	—
Corporate debt	—	—	238,500	238,500
Subordinated notes	189,852	253,382	156,831	184,087

The carrying amounts shown in the table are included in the consolidated balance sheets under the indicated captions.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

The following table presents the carrying amounts, estimated fair values, and placement in the fair value hierarchy of the Company's financial instruments at September 30, 2015 and December 31, 2014. The table excludes financial instruments for which the carrying amount approximates fair value such as cash and cash equivalents, restricted cash, investments in debt securities available-for-sale, and financial information disclosed above.

September 30, 2015	Carrying		Fair Value Measurements		
	amount	Fair value	Level 1	Level 2	Level 3
	(\$ in thousands)				
<b>Financial assets:</b>					
Loans and leases, net	\$2,991,370	\$3,016,543	\$—	\$—	\$3,016,543
Loans held-for-sale	427,418	427,418	—	427,418	—
Other assets	11,227	11,227	—	—	11,227
<b>Financial liabilities:</b>					
Credit facilities	625,595	625,595	—	625,595	—
Term debt securitizations	1,890,765	1,880,704	—	1,880,704	—
Repurchase agreements	137,640	142,337	—	142,337	—
Senior notes	300,000	297,930	—	297,930	—
Subordinated notes	189,852	253,282	—	—	253,282

December 31, 2014	Carrying		Fair Value Measurements		
	amount	Fair value	Level 1	Level 2	Level 3
	(\$ in thousands)				
<b>Financial assets:</b>					
Loans and leases, net	\$2,305,896	\$2,314,271	\$—	\$—	\$2,314,271
Loans held-for-sale	200,569	200,569	—	200,569	—
Other assets	15,613	15,613	—	—	15,613
<b>Financial liabilities:</b>					
Credit facilities	487,768	487,768	—	487,768	—
Term debt securitizations	1,193,187	1,163,803	—	1,163,803	—
Repurchase agreements	57,227	63,507	—	63,507	—
Subordinated notes	156,831	184,087	—	—	184,087

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents, restricted cash and cash collateral on deposit with custodian: The carrying amounts approximate fair value because of the short maturity of these instruments.

Loans held-for-sale, net: The fair values are based on quoted prices, where available, cost, or are determined by discounting estimated cash flows using model-based valuation techniques. Inputs into the model-based valuations can include changes in market indexes, selling prices of similar loans, management's assumption related to credit rating of the loan, prepayment assumptions and other factors, such as credit loss assumptions.

Loans and leases, net: The fair value was determined as the present value of expected future cash flows discounted at current market interest rates offered by similar lending institutions for loans with similar terms to companies with comparable credit risk. This method of estimating fair value does not incorporate the exit price concept of fair value and is based on significant unobservable inputs. The amount included in the above table excludes impaired collateral-dependent commercial real estate loans.

Investments in debt securities: The fair values of debt securities are based on quoted market prices, when available, at the reporting date for those or similar investments. When no market data is available, we estimate fair value using various valuation tools including cash flow models that utilize financial statements and business plans, as well as qualitative factors.

Credit facilities: Due to the adjustable rate nature of the borrowings, the fair values of the credit facilities are estimated to be their carrying values. Rates currently are comparable to those offered to the Company for similar debt instruments of comparable maturities by the Company's lenders.

Term debt securitizations: The fair value was determined by applying prevailing term debt securitization market interest rates to the Company's current term debt securitization structure.

Repurchase agreements: The fair value was determined by applying prevailing repurchase agreement market interest rates to the Company's current repurchase agreement structure.

Senior notes: The fair value is based on quoted market prices.

Subordinated notes: The fair value was estimated as the present value of expected future cash flows discounted at market interest rates on similar debt instruments, issued by companies with comparable credit ratings.

Corporate debt: The fair value was determined as the present value of future cash flows discounted at market interest rates on similar debt instruments.

Other assets: Comprised of non-public investments which are initially valued at transaction price and subsequently adjusted when evidence is available to support such adjustments when appropriate. The estimated fair value was determined based on the Company's valuation techniques, including discounting estimated cash flows and model-based valuations.

#### Note 13. Related-Party Transactions

On January 15, 2015, the Company announced the closing of the NewStar Clarendon Fund CLO LLC (the "Clarendon Fund"), a \$400.0 million term debt securitization. The Clarendon Fund is the third credit fund established by the Company to co-invest in directly originated middle market commercial loans. To comply with EU risk retention rules, the Company holds 5% of each class of note in the securitization, totaling \$20.4 million. The Clarendon Fund employs an independent investment professional who is responsible for investment decision making on behalf of the program. The Company has determined that it is not the primary beneficiary of the Clarendon Fund and will not consolidate the Clarendon Fund's operating results or statements of financial position. Pursuant to a Collateral Management Agreement dated January 15, 2015, the Company serves as collateral manager of the Clarendon Fund. The Company is entitled to receive a fee, which will accrue quarterly based on the fee basis amount in arrears payable on each payment date. For the three and nine months ended September 30, 2015, the Clarendon Fund's collateral management fee was \$0.5 million and \$1.5 million, respectively.

Pursuant to a Collateral Management Agreement dated June 26, 2014, the Company serves as collateral manager of the Arlington Program. The Company is entitled to receive a fee, which will accrue quarterly based on the fee basis amount in arrears payable on each payment date. For the three and nine months ended September 30, 2015, the Arlington Program's collateral management fee was \$0.5 million and \$1.5 million, respectively, and for the three months ended September 30, 2014, the Fund paid the Company \$0.1 million.

Pursuant to an Investment Management Agreement dated August 3, 2005, the Company serves as investment manager of the NewStar Credit Opportunities Fund, Ltd. (the "Fund"), a Cayman Islands exempted company limited by shares incorporated under the provisions of The Companies Law of the Cayman Islands. The Fund pays the Company a fee when cash is distributed to its investors. For the three and nine months ended September 30, 2015, the Fund paid the Company \$0.1 million and \$0.1 million, respectively and for the three and nine months ended September 30, 2014, the Fund paid the Company \$0.0 and \$0.1 million, respectively.



Note 14. Subsequent Events

FOC Capital Acquisition

On October 7, 2015 the Company acquired 100% of the outstanding limited liability company interests of Feingold O’Keeffe Capital, L.L.C (“FOC Capital”) for a purchase price of \$20.9 million in cash. FOC Capital is a private, alternative asset management firm headquartered in Boston, Massachusetts. The acquisition will be accounted for as a business combination and will be consolidated in the financial statements of the Company effective October 7, 2015. The Company has not completed the evaluation and allocation of the purchase price.

Stock Repurchase Program

On October 7, 2015, the Company’s Board of Directors authorized the repurchase of up to \$5 million of the Company’s common stock from time to time on the open market or in privately negotiated transactions. The timing and amount of any shares purchased will be determined by the Company’s management based on its evaluation of market conditions and other factors. The repurchase program, which will expire on March 31, 2016 unless extended by the Board of Directors, may be suspended or discontinued at any time without notice.

Subordinated Notes borrowing

On October 26, 2015, the Company drew an additional \$25 million of the Subordinated Notes, under the existing commitment from funds managed by GSO Capital and Franklin Square, bringing the outstanding to \$275 million leaving \$25 million remaining to be drawn by December 2015.

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

The following discussion contains forward-looking statements. Important factors that may cause actual results and circumstances to differ materially from those described in such statements are described in Item 1A of our Annual Report on Form 10-K, as amended, for the year ended December 31, 2014, as well as throughout this Item 2. You are cautioned not to place undue reliance on the forward-looking statements contained in this document. These statements speak only as of the date of this document, and we undertake no obligation to update or revise these statements, except as may be required by law.

### Overview

NewStar Financial, Inc. is an internally-managed, commercial finance company with specialized lending platforms focused on meeting the complex financing needs of companies and private investors in the middle market. The Company is also a registered investment adviser and provides asset management services to institutional investors through a series of managed credit funds that co-invest in certain types of loans originated by the Company. Through its specialized lending platforms, the Company provides a range of senior secured debt financing options to mid-sized companies to fund working capital, growth strategies, acquisitions and recapitalizations, as well as, purchases of equipment and other capital assets.

These lending activities require specialized skills and transaction experience, as well as, a significant investment in personnel and operating infrastructure. To meet these demands, our loans and leases are originated directly by teams of credit-trained bankers and experienced marketing officers organized around key industry and market segments. These teams represent specialized lending groups that are supported by centralized credit management and operating platforms, which enables us to leverage common standards, systems, and industry and professional expertise across multiple businesses.

We direct our marketing and origination efforts to private equity firms, mid-sized companies, corporate executives, banks, real estate investors and a variety of other referral sources and financial intermediaries to develop new customer relationships and source lending opportunities. Our origination network is national in scope and we focus on companies operating across a broad range of industry sectors. We employ highly experienced bankers, marketing officers and credit professionals to identify and structure new lending opportunities and manage customer relationships. We believe that the quality of our professionals, the breadth of their relationships and referral networks, and their ability to develop creative solutions for customers position us to be a valued partner and preferred lender for mid-sized companies and private equity funds with middle market investment strategies.

Our emphasis on direct origination is an important aspect of our marketing and credit strategy. Our national network is designed around specialized origination channels intended to generate a large set of potential lending opportunities. That allows each lending platform to be highly selective in our credit process and to allocate capital to market segments that we believe represent the most attractive opportunities. Our direct origination network also generates

proprietary lending opportunities with yield characteristics that we believe would not otherwise be available through intermediaries. In addition, direct origination provides us with direct access to management teams and enhances our ability to conduct detailed due diligence and credit analysis of prospective borrowers. It also allows us to negotiate transaction terms directly with borrowers and, as a result, advise our customers' financial strategies and capital structures, which we believe benefits our credit performance.

The Company typically provides financing commitments to companies in amounts that range in size from \$10 million to \$50 million. The size of financing commitments depends on various factors, including the type of loan, the credit characteristics of the borrower, the economic characteristics of the loan, and our role in the transaction. We also selectively arrange larger transactions that we may retain on our balance sheet or syndicate to other lenders, which may include funds that we manage for third party institutional investors. By syndicating loans to other lenders and our managed funds, we are able to provide larger financing commitments to our customers and generate fee income, while limiting our risk exposure to single borrowers. From time to time, however, our balance sheet exposure to a single borrower may exceed \$35 million.

NewStar offers a set of credit products and services that have many common attributes, but which are highly specialized by lending group and market segment. Although both the Leveraged Finance and Business Credit lending groups structure loans as revolving credit facilities and term loans, the style of lending and approach to credit management is highly specialized. The Equipment Finance group broadens our product offering to include a range of lease financing options. The operational intensity of each product also varies by lending group.

Although NewStar operates as a single segment, the Company derives revenues from asset management services and lending activities across four specialized lending groups that target market segments in which we believe that we have competitive advantages:

- Leveraged Finance, provides senior, secured cash flow loans and, to a lesser extent, first out, second lien and unitranche loans, which are primarily used to finance acquisitions of mid-sized companies with annual cash flow (EBITDA) typically between \$10 million and \$50 million by private equity investment funds managed by established professional alternative asset managers;
- Business Credit, provides senior, secured asset-based loans primarily to fund working capital needs of mid-sized companies with sales revenue typically totaling between \$25 million and \$500 million;
- Real Estate, provides first mortgage debt primarily to finance acquisitions of commercial real estate properties typically valued between \$10 million and \$50 million by professional commercial real estate investors;
- Equipment Finance, provides leases, loans and lease lines to finance purchases of equipment and other capital expenditures typically for companies with annual sales of at least \$25 million; and
- Asset Management, provides opportunities for qualified institutions to invest in credit funds managed by the Company with strategies to co-invest in loans originated by its Leveraged Finance lending group.

#### Market Conditions

Market conditions in segments of the loan market that we target were mixed in the third quarter compared to the prior quarter as volume declined and pricing increased. According to Thomson Reuters, overall middle market loan volume in the third quarter decreased as compared to prior quarter and decreased compared to the same period in 2014, with volume of approximately \$27 billion in the third quarter versus \$42 billion prior quarter and versus \$47 billion in the third quarter of 2014. The volume represented by new middle market transactions, as opposed to refinancing transactions, decreased in the third quarter to \$10.6 billion from \$17.6 billion in the second quarter; refinancing volume decreased to \$16.7 billion in the third quarter of 2015 from \$24.9 billion in the second quarter. As a percentage of total volume, new transactions were around 39%, down slightly from 41% last quarter and 47% in the same period last year.

After yields tightened through the first half of 2015, the pricing environment in our target markets improved in the third quarter, as loan yields in both the large corporate market and middle market increased. Large corporate loan yields were up to 5.1% in the third quarter from 4.8% in the second quarter but down as compared to 5.4% in the same quarter last year. Middle market loan yields were up to 6.3% in the third quarter from 6.0% in the second quarter and up from 6.1% in the same quarter last year, continuing to exhibit a premium versus large corporate loans. With most of the new money flowing into the loan market from CLO issuance and retail loan funds targeted for broadly syndicated loans, we believe that market conditions will continue to be more challenging for large corporate lenders and that the middle market will continue to compare favorably.

Our different lending platforms provide us with certain flexibility to allocate capital and redirect our origination focus to market segments with the most favorable conditions in terms of demand and relative value. As the pricing environment for larger, more liquid loans was less attractive in the third quarter and loan demand among private equity firms in the middle market remained somewhat firmer, we continued to emphasize direct lending to smaller companies during the quarter. We believe that the yields on our new loan origination will continue to reflect a combination of these broad market trends and shifts in the mix of loans we originate.

Conditions in our core funding markets have generally remained steady in the third quarter as fixed income investors continued to target structured investment alternatives such as CLOs to meet their return objectives. Despite remaining regulatory headwinds and softening equity demand, the new issue CLO market continues to remain stable, only slightly lagging pace with record issuance volume last year. The broader fixed income markets remained active in the quarter as the market seems to have adjusted to potential changes in the Federal Reserve's monetary policies. As a result, we believe that investors will continue to be cautious about holding fixed rate debt, leading to less capital flowing into the high yield market in favor of high yielding investments with shorter duration, including floating rate

bank loans and CLO bonds.

New U.S. CLO issuance in the third quarter was approximately \$18 billion, a 44% decrease versus the same quarter in 2014, and \$79 billion in issuance year to date, which lags behind the \$92 billion total through the same period last year. Total U.S. CLO issuance in 2014, 2013 and 2012 was approximately \$124 billion, \$81 billion and \$55 billion, respectively. Due to interest rate uncertainty and regulatory pressure, CLO credit spreads have seen some upward movement since the end of 2014 and through the third quarter of 2015. We believe marginal funding costs will be somewhat range bound at current levels until investors reset rate/return expectations and resolve regulatory issues. Despite this trend in the pricing environment, we believe that market conditions remain supportive for us to issue new CLOs. We also believe the availability and cost of warehouse financing among banks remains stable as more banks have begun to provide this type of financing and existing providers have increased their lending activity. As a

result, we believe that the terms and conditions for financings available to established firms like NewStar will continue to be favorable.

Loan demand in the middle market is strongly influenced by the level of refinancing, acquisition activity and private investment, which is driven largely by changes in the perceived risk environment, prevailing borrowing rates and private investment activity. These factors were generally favorable in the third quarter as we originated over \$700 million of new loans and leases at attractive yields. With pricing widening, leverage remaining below the broader loan market, and equity contributions increasing, conditions in our primary target markets continued to remain favorable relative to the broader loan market in which larger corporations typically borrow from syndicates of banks and loans are issued, priced and traded in a bond-style market that is more highly correlated with the high yield debt market. We believe that demand for new middle market loans and credit products will remain relatively consistent with current levels in the near term and exhibit usual seasonality. Over the long-term, we believe that demand will improve because private equity firms have substantial un-invested capital, which we believe that they will deploy through investment strategies that emphasize investments in mid-sized companies. As a result of these factors, we anticipate that demand for loans and leases offered by the Company and conditions in our lending markets will remain favorable through 2015 and continue to provide opportunities for us to increase our origination volume.

#### Recent Developments

##### Liquidity

On September 15, 2015 we completed an \$298.4 million term debt securitization and issued \$351.0 million of notes backed by cash, specific loans and investments. The 2015-2 CLO permits reinvestment of collateral principal repayments for a four-year period ending in August 2019. The Notes are expected to mature in August 2027.

On September 1, 2015 we completed an \$100.1 million static asset-backed securitization and issued \$82.9 million of notes backed by a diversified portfolio of leases and equipment loans originated by our equipment finance line of business. The Class A Notes are expected to mature in April 2019, and the Class B Notes are expected to mature in January 2024.

On August 10, 2015, we entered into an amendment to our credit facility with syndicated lenders agented by Wells Fargo Bank, National Association to fund leveraged finance loans which, among other things, increased the commitment amount to \$475.0 million from \$425.0 million, extended both the revolving period to August 10, 2018 and the final maturity date to August 10, 2020, and modified certain concentration limits.

On August 5, 2015, we entered into an amendment to our credit facility with Citibank, N.A. to fund leveraged finance loans. The amendment increased the commitment amount to \$250.0 million from \$175.0 million.

##### Stock Repurchase

As of September 30, 2015, we had completed the stock repurchase program approved on August 13, 2014 pursuant to which we repurchased 892,911 shares of our common stock at a weighted average price of \$11.20 per share.

On October 7, 2015, our Board of Directors authorized the repurchase of up to \$5 million of the Company's common stock from time to time in open market or in privately negotiated transactions. The timing and amount of any shares purchased will be determined by our management based on market conditions and other factors. This repurchase program will expire by its terms on March 31, 2016, unless extended by our Board of Directors, and may be

suspended or discontinued at any time without notice.

**RESULTS OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2015 AND 2014**

NewStar's basic and diluted income per share for the three months ended September 30, 2015 was \$0.11 and \$0.11, respectively, on net income of \$5.1 million and basic and diluted income per share of \$0.27 and \$0.26, respectively for the nine months ended September 30, 2015 on net income of \$12.7 million, compared to basic and diluted income per share for the three months ended September 30, 2014 of \$0.10 on a net income of \$5.0 million, and basic and diluted income per share of \$0.19 and \$0.18, respectively, for the nine months ended September 30, 2014, on net income of \$9.4 million. Our managed portfolio was \$4.6 billion at September 30, 2015 compared to \$3.4 billion at December 31, 2014. Our managed assets totaled \$4.9 billion at September 30, 2015 compared to \$3.8 billion as of December 31, 2014.

### Loan portfolio yield

Loan portfolio yield, which is interest income on our loans and leases divided by the average balances outstanding of our loans and leases, was 6.32% and 6.19% for the three and nine months ended September 30, 2015 and 6.13% and 6.12% for the three and nine months ended September 30, 2014. The increase in loan portfolio yield was primarily driven by an increase in our average yield on interest earning assets from new loan and lease origination and re-pricings subsequent to September 30, 2014.

### Net interest margin

Net interest margin, which is net interest income divided by average interest earning assets, was 2.57% and 2.35% during the three and nine months ended September 30, 2015 and 3.24% for each of the three and nine months ended September 30, 2014. The primary factors impacting net interest margin for the three months ended September 30, 2015 were higher income from debt securities, normalization of interest expense after prior quarter acceleration of deferred financing costs and a mix of CLO liabilities. Net interest margin for the nine months ended September 30, 2015 was also impacted by the acceleration of amortization of \$3.6 million of deferred financing fees related to the payoff of the Fortress corporate credit facility with a portion of the proceeds from the issuance of senior notes. Excluding the \$3.6 million of accelerated amortization of deferred financing fees, the net interest margin for the nine months ended would have been 2.49%. The primary factors impacting net interest margin for the three and months ended September 31, 2014 were the acceleration of amortization of \$1.1 million of deferred financing fees related to the Arlington Fund's payoff of its credit facility with a portion of the proceeds from the Arlington Program's term debt securitization, the composition of interest earning assets, non-accrual loans, changes in three-month LIBOR, credit spreads and cost of borrowings.

### Operating expenses as a percentage of average total assets

Operating expenses as a percentage of average total assets was 1.45% and 1.43% for the three and nine months ended September 30, 2015 and 1.79% and 1.86% for the three and nine months ended September 30, 2014. The decrease for the three and nine months ended September 30, 2015 as compared to the three and nine months ended September 30, 2014 was primarily due to originations that increased average total assets subsequent to September 30, 2014. Operating expenses were relatively flat during the respective nine month periods.

### Efficiency ratio

Our efficiency ratio, which is total operating expenses divided by net interest income before provision for credit losses plus total non-interest income, was 50.07% and 49.05% the three and nine months ended September 30, 2015 and 48.03% and 48.15% for the three and nine months ended September 30, 2014, respectively. The increase in our efficiency ratio for the three months ended September 30, 2015 as compared to the three months ended September 30, 2014 was primarily due to increased operating expense primarily related to compensation. The increase in our efficiency ratio for the nine months ended September 30, 2015 as compared to the nine months ended September 30, 2014 was primarily due to increased interest expense driven by an increase in our interest bearing liabilities.

### Allowance for credit losses ratio

Allowance for credit losses ratio, which is allowance for credit losses divided by outstanding gross loans and leases excluding loans held-for-sale, was 1.76% at September 30, 2015 and 1.84% as of December 31, 2014. The decrease in the allowance for credit losses ratio from December 31, 2014 is primarily due to the increased mix of recently originated loans as a percentage of the overall portfolio, this was partially offset by the increase in general provision primarily driven by an increase in outstanding loans and leases, and an increase in the specific allowance of \$3.1 million. During the nine months ended September 30, 2015, we recorded \$7.1 million of net specific provision for credit losses on impaired loans and had charge offs net of recoveries totaling \$3.9 million. At September 30, 2015, the



specific allowance for credit losses was \$23.8 million, and the general allowance for credit losses was \$30.7 million. At December 31, 2014, the specific allowance for credit losses was \$20.7 million, and the general allowance for credit losses was \$23.0 million. We continually evaluate our allowance for credit losses methodology. If we determine that a change in our allowance for credit losses methodology is advisable, as a result of the changes in the economic environment or otherwise, the revised allowance methodology may result in higher or lower levels of allowance. Moreover, actual losses under our current or any revised methodology may differ materially from our estimate.

#### Delinquent loan rate

Delinquent loan rate, which is total delinquent loans net of charge offs with outstanding cash receivables that are 60 days or more past due, divided by outstanding gross loans and leases, was 0.93% as of September 30, 2015 as compared to 1.84% as of December 31, 2014. We had delinquent loans with an outstanding balance of \$28.6 million and \$43.6 million as of September 30, 2015 and December 31, 2014, respectively. We expect the delinquent loan rate to correlate to current economic conditions. During times of economic expansion we expect the rate to decline, and during times of economic contraction, we expect the rate to increase.

Delinquent loan rate for accruing loans 60 days or more past due

Delinquent loan rate for accruing loans 60 days or more past due, which is total delinquent accruing loans net of charge offs with outstanding cash receivables that are 60 days or more past due and less than 90 days past due, divided by outstanding gross loans and leases. At September 30, 2015, we had one loan past its stated maturity which we are in the process of amending, this loan has a balance of \$8.5 million. We had did not have any delinquent accruing loans as of December 31, 2014.

Non-accrual loan rate

Non-accrual loan rate is defined as total balances outstanding of loans on non-accrual status divided by the total outstanding balance of our loans and leases held for investment. Loans are put on non-accrual status if they are 90 days or more past due or if management believes it is probable that the Company will be unable to collect contractual principal and interest in the normal course of business. The non-accrual loan rate was 3.48% as of September 30, 2015 and 3.70% as of December 31, 2014. As of September 30, 2015 and December 31, 2014, the aggregate outstanding balance of non-accrual loans was \$107.7 million and \$87.8 million, respectively and total outstanding loans and leases held for investment was \$3.1 billion and \$2.4 billion, respectively. We expect the non-accrual loan rate to correlate to economic conditions. During times of economic expansion we expect the rate to decline, and during times of economic contraction, we expect the rate to increase, although actual results may vary.

Non-performing asset rate

Non-performing asset rate is defined as the sum of total balances outstanding of loans on non-accrual status and other real estate owned, divided by the sum of the total outstanding balance of our loans and leases held for investment and other real estate owned. The non-performing asset rate was 3.48% as of September 30, 2015 and 3.84% as of December 31, 2014. As of September 30, 2015 and December 31, 2014, the sum of the aggregate outstanding balance of non-performing assets was \$107.7 million and \$91.0 million, respectively. We expect the non-performing asset rate to correlate to economic conditions. During times of economic expansion we expect the rate to decline, and during times of economic contraction, we expect the rate to increase, although actual results may vary.

Net charge off rate (end of period loans and leases)

Net charge off rate as a percentage of end of period loan and lease portfolio is defined as annualized charge-offs net of recoveries divided by the total outstanding balance of our loans and leases held for investment. A charge-off occurs when management believes that all or part of the principal of a particular loan is no longer recoverable and will not be repaid. Typically a charge off occurs in a period after a loan has been identified as impaired and a specific allowance has been established. The net charge-off rate was zero and 0.17% for the three and nine months ended September 30, 2015, and 0.11% and 1.38% for the three and nine months ended September 30, 2014. We expect the net charge-off rate (end of period loans and leases) to correlate to economic conditions. During times of economic expansion we expect the rate to decline, and during times of economic contraction, we expect the rate to increase, although actual results may vary.

Net charge off rate (average period loans and leases)

Net charge off rate as a percentage of average period loan and lease portfolio is defined as annualized charge-offs net of recoveries divided by the average total outstanding balance of our loans and leases held for investment for the period. The net charge-off rate was zero and 0.18% for the three and nine months ended September 30, 2015, and 0.10% and 1.27% for the three and nine months ended September 30, 2014. We expect the net charge-off rate (average period loans and leases) to correlate to economic conditions. During times of economic expansion we expect the rate to decline, and during times of economic contraction, we expect the rate to increase, although actual results may vary.

Return on average assets

Return on average assets, which is net income divided by average total assets, was 0.56% and 0.52% for the three and nine months ended September 30, 2015 and 0.82% and 0.50% for the three and nine months ended September 30, 2014, respectively.

Return on average equity

Return on average equity, which is net income divided by average equity, was 3.10% and 2.58% for the three and nine months ended September 30, 2015 and 3.28% and 2.03% for the three and nine months ended September 30, 2014.

## Review of Consolidated Results

A summary of NewStar Financial's consolidated financial results for the three and nine months ended September 30, 2015 and 2014 follows:

	Three Months		Nine Months Ended	
	Ended September 30, 2015	2014	September 30, 2015	2014
	(\$ in thousands)			
<b>Net interest income:</b>				
Interest income	\$54,574	\$33,907	\$141,194	\$100,570
Interest expense	31,345	14,304	84,764	40,673
Net interest income	23,229	19,603	56,430	59,897
Provision for credit losses	4,534	3,369	14,720	21,828
Net interest income after provision for credit losses	18,695	16,234	41,710	38,069
<b>Non-interest income:</b>				
Fee income	4,573	740	10,508	1,972
Asset management income	1,019	488	2,954	543
Loss on derivatives	(5 )	(10 )	(24 )	(27 )
Gain (loss) on sale of loans, net	360	(23 )	314	(189 )
Other income (expense), net	(2,455 )	2,066	1,295	9,176
Total non-interest income (loss)	3,492	3,261	15,047	11,475
<b>Operating expenses:</b>				
Compensation and benefits	9,561	7,721	24,004	23,283
General and administrative expenses	3,819	3,260	11,052	11,481
Total operating expenses	13,380	10,981	35,056	34,764
Operating income before income taxes	8,807	8,514	21,701	14,780
<b>Results of Consolidated Variable Interest Entity</b>				
Interest income	-	-	-	5,268
Interest expense – credit facilities	-	-	-	2,865
Interest expense – Fund membership interest	-	-	-	1,292
Other income	-	-	-	229
Operating expenses	-	-	-	249
Net results from Consolidated Variable Interest Entity	-	-	-	1,091
Income before income taxes	8,807	8,514	21,701	15,871
Income tax expense	3,665	3,494	9,020	6,503
Net income	\$5,142	\$5,020	\$12,681	\$9,368

## Comparison of the Three Months Ended September 30, 2015 and 2014

**Interest income.** Interest income increased \$20.7 million, to \$54.6 million for the three months ended September 30, 2015 from \$33.9 million for the three months ended September 30, 2014. The increase was primarily due to an increase in average balance of our interest earning assets to \$3.6 billion from \$2.4 billion primarily due to new loan origination subsequent to September 30, 2014 and an increase in the yield on average interest earning assets to 6.05% from 5.61%.

Interest expense. Interest expense increased \$17.0 million, to \$31.3 million for the three months ended September 30, 2015 from \$14.3 million for the three months ended September 30, 2014. The increase is primarily due to an increase in the average balance of our interest bearing liabilities to \$2.9 billion from \$1.8 billion, and an increase in the average cost of funds to 4.31% from 3.16%, primarily due to increased borrowings under certain credit facilities with higher interest rates, the additional draw on the Subordinated Notes and \$300.0 million of high yield notes issued the second quarter.

Net interest margin. Net interest margin decreased to 2.57% for the three months ended September 30, 2015 from 3.24% for the three months ended September 30, 2014. The decrease in net interest margin was primarily due to an increase in our average cost of interest bearing liabilities. The net interest spread, the difference between gross yield on our interest earning assets and the total cost of our interest bearing liabilities, decreased to 1.74% from 2.45%.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

The following table summarizes the yield and cost of interest earning assets and interest bearing liabilities for the three months ended September 30, 2015 and 2014:

	Three Months Ended September 30, 2015 (\$ in thousands)				Three Months Ended September 30, 2014		
	Interest		Average		Interest		Average
	Average	Income/	Yield/		Average	Income/	Yield/
	Balance	Expense	Cost		Balance	Expense	Cost
Total interest earning assets	\$3,579,431	\$54,574	6.05 %		\$2,398,564	\$33,907	5.61 %
Total interest bearing liabilities	2,882,669	31,345	4.31 %		1,794,368	14,304	3.16 %
Net interest spread		\$23,229	1.74 %			\$19,603	2.45 %
Net interest margin			2.57 %				3.24 %

Provision for credit losses. The provision for credit losses increased \$1.2 million to \$4.5 million for the three months ended September 30, 2015 from \$3.4 million for the three months ended September 30, 2014. The increase in the provision was primarily due to an increase of \$1.3 million of general provisions recorded during the three months ended September 30, 2015 as compared to three months ended September 30, 2014, which was primarily a result of loan growth. During the three months ended September 30, 2015, we recorded net specific provisions for impaired loans of \$1.6 million compared to \$1.8 million recorded during the three months ended September 30, 2014. Our general allowance for credit losses covers probable losses in our loan and lease portfolio with respect to loans and leases that are not impaired and for which no specific impairment has been identified. A specific provision for credit losses is recorded with respect to loans for which it is probable that we will be unable to collect all amounts due in accordance with the contractual terms of the loan agreement for which there is impairment recognized. The Company employs a variety of internally developed and third-party modeling and estimation tools for measuring credit risk, which are used in developing an allowance for loan and lease losses on outstanding loans and leases. The Company's allowance framework addresses economic conditions, capital market liquidity and industry circumstances from both a top-down and bottom-up perspective. The Company considers and evaluates a number of factors, including but not limited to, changes in economic conditions, credit availability, industry, loss emergence period, and multiple obligor concentrations in assessing both probabilities of default and loss severities as part of the general component of the allowance for loan and lease losses.

On at least a quarterly basis, loans and leases are internally risk-rated based on individual credit criteria, including loan and lease type, loan and lease structures (including balloon and bullet structures common in the Company's Leveraged Finance and Real Estate loans), borrower industry, payment capacity, location and quality of collateral if any (including the Company's Real Estate loans). Borrowers provide the Company with financial information on either a monthly or quarterly basis. Ratings, corresponding assumed default rates and assumed loss severities are dynamically updated to reflect any changes in borrower condition or profile.

For Leveraged Finance loans and Equipment Finance products, the data set used to construct probabilities of default in its allowance for loan losses model, Moody's CRD Private Firm Database, primarily contains middle market loans that share attributes similar to the Company's loans. The Company also considers the quality of the loan or lease terms and lender protections in determining a loan loss in the event of default.

For Business Credit loans, the Company utilizes a proprietary model to risk rate the loans on a monthly basis. This model captures the impact of changes in industry and economic conditions as well as changes in the quality of the

borrower's collateral and financial performance to assign a final risk rating. The Company has also evaluated historical loss trends by risk rating from a comprehensive industry database covering more than twenty-five years of experience of the majority of the asset based lenders operating in the United States. Based upon the monthly risk rating from the model, the reserve is adjusted to reflect the historical average for expected loss from the industry database.

For Real Estate loans, the Company employs two mechanisms to capture the impact of industry and economic conditions. First, a loan's risk rating, and thereby its assumed default likelihood, can be adjusted to account for overall commercial real estate market conditions. Second, to the extent that economic or industry trends adversely affect a substandard rated borrower's loan-to-value ratio enough to impact its repayment ability, the Company applies a stress multiplier to the loan's probability of default. The multiplier is designed to account for default characteristics that are difficult to quantify when market conditions cause commercial real estate prices to decline.

For consolidated variable interest entities to which the Company is providing transitional capital, we utilize a qualitative analysis which considers the business plans related to the entity, including expected hold periods, the terms of the agreements related to the entity, the Company's historical credit experience, the credit migration of the entity's loans in determining expected loss, as well as conditions in the capital markets. The Company provided capital on a transitional basis to the Arlington Fund. We deconsolidated the Arlington Fund on June 26, 2014. We did not recognize any losses on loans on the date of deconsolidation.

The Company periodically reviews its allowance for credit loss methodology to assess any necessary adjustments based upon changing economic and capital market conditions. If the Company determines that changes in its allowance for credit losses methodology are advisable, as a result of changes in the economic environment or otherwise, the revised allowance methodology may result in higher or lower levels of allowance. There have been no material modifications to the allowance for credit losses methodology during 2015. Actual losses under the Company's current or any revised allowance methodology may differ materially from the Company's estimate.

Additionally, when determining the amount of the general allowance, the Company supplements the base amount with an environmental reserve amount which is governed by a score card system comprised of ten individually weighted risk factors. The risk factors are designed based on those outlined in the Comptrollers of the Currency's Allowance for Loan and Lease Losses Handbook. The Company also performs a ratio analysis of comparable money center banks, regional banks and finance companies. While the Company does not rely on this peer group comparison to set the level of allowance for credit losses, it does assist management in identifying market trends and serves as an overall reasonableness check on the allowance for credit losses computation.

A loan is considered impaired when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impairment of a loan is based upon (i) the present value of expected future cash flows discounted at the loan's effective interest rate, (ii) the loan's observable market price, or (iii) the fair value of the collateral if the loan is collateral dependent, depending on the circumstances and our collection strategy. Impaired loans are identified based on the loan-by-loan risk rating process described above. Impaired loans include all non-accrual loans, loans with partial charge-offs and loans which are Troubled Debt Restructurings. It is the Company's policy during the reporting period to record a specific provision for credit losses to cover the identified impairment on a loan.

Impaired loans at September 30, 2015 were in Leveraged Finance, Real Estate, and Equipment Finance over a range of industries impacted by the then current economic environment including the following: Media and Communications, Industrial, Commercial Real Estate, Other Business Services, Consumer/Retail, and Building Materials. For impaired Leveraged Finance loans, the Company measured impairment based on expected cash flows utilizing relevant information provided by the borrower and consideration of other market conditions or specific factors impacting recoverability. Such amounts are discounted based on original loan terms. For impaired Real Estate loans, the Company determined that the loans were collateral dependent and measured impairment based on the fair value of the related collateral utilizing recent appraisals from third-party appraisers, as well as internal estimates of market value. As of September 30, 2015, we had impaired loans and leases with an aggregate outstanding balance of \$201.2 million. Impaired loans with an aggregate outstanding balance of \$160.4 million have been restructured and classified as troubled debt restructurings. At September 30, 2015, the Company had a \$23.8 million specific allowance for impaired loans with an aggregate outstanding balance of \$131.3 million. As of September 30, 2015, we had one restructured impaired loan which had an outstanding balance greater than \$20 million and one restructured impaired loan which had an outstanding balance greater than \$30 million. In each of these cases, we added to our position to maximize our potential recovery of the outstanding principal.

Non-interest income. Non-interest income increased \$0.2 million, to \$3.5 million for the three months ended September 30, 2015 from \$3.3 million for the three months ended September 30, 2014. For the three months ended September 30, 2015, non-interest income was primarily comprised of \$4.6 million of fee income comprised primarily of capital markets fees, such as arrangement, syndication and advisory fees, \$1.0 million of asset management fees, \$0.7 million of unused fees, a \$0.4 million gain on sale of loans, \$0.3 million gain on sale of equipment at maturity of lease, offset by a \$3.0 million unrealized loss on a total return swap, and \$0.5 million of loss from an impairment charge on an equity position we held as a result of a loan that we had previously restructured. For the three months ended September 30, 2014, non-interest income was primarily comprised of \$0.9 million of income from other real estate owned properties, \$0.7 million of fee income, \$0.5 million of unused fees, a \$0.2 million increase in the value



of an other real estate owned property, and \$0.5 million of miscellaneous fees.

As a result of certain of our troubled debt restructurings, we have received equity interests in several of our impaired borrowers. The equity interests in certain impaired borrowers is initially recorded at fair value when the debt is restructured and is subsequently analyzed at the end of each quarter. In situations where we are deemed to be under the equity method of accounting, we record our ownership share of the borrowers' results of operations in non-interest income. Additionally, our corresponding share of our borrowers' results of operations may directly impact the remaining net book value of these respective loans. These equity interests may give rise to potential capital gains or losses, for tax purposes. This could impact future period tax rates depending on our ability to recognize capital losses to the extent of any capital gains.

Operating expenses. Operating expenses increased \$2.4 million, to \$13.4 million for the three months ended September 30, 2015 from \$11.0 million for the three months ended September 30, 2014. Compensation and benefits expense increased \$1.8 million and general and administrative expenses increased \$0.6 million.

Income taxes. For the three months ended September 30, 2015 and 2014, we provided for income taxes based on an effective tax rate of 42% and 41%, respectively.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

As of September 30, 2015 and December 31, 2014, we had net deferred tax assets of \$35.6 million and \$28.1 million, respectively. In assessing if we will be able to realize our deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. We considered all available evidence, both positive and negative, in determining the realizability of deferred tax assets at September 30, 2015. We considered carryback availability, the scheduled reversals of deferred tax liabilities, projected future taxable income during the reversal periods, and tax planning strategies in making this assessment. We also considered our recent history of taxable income, trends in our earnings and tax rate, positive financial ratios, and the current economic environment (including the impact of credit on allowance and provision for loan losses; and the impact on funding levels) on the Company. Based upon our assessment, we believe that a valuation allowance was not necessary as of September 30, 2015. As of September 30, 2015, our deferred tax asset was primarily comprised of \$25.8 million related to our allowance for credit losses and \$9.6 million related to equity compensation, which was partially offset by deferred tax liabilities related to our Equipment Finance portfolio.

Comparison of the Nine Months Ended September 30, 2015 and 2014

**Interest income.** Interest income increased \$35.4 million, to \$141.2 million for the nine months ended September 30, 2015 from \$105.8 million on a consolidated basis for the nine months ended September 30, 2014. The increase was primarily due to an increase in average balance of our interest earning assets to \$3.2 billion from \$2.5 billion primarily due to new loan origination subsequent to September 30, 2014, and an increase in the yield on average interest earning assets to 5.87% from 5.62%.

**Interest expense.** Interest expense increased \$40.0 million, to \$84.8 million for the nine months ended September 30, 2015 from \$44.8 million on a consolidated basis for the nine months ended September 30, 2014. The increase is primarily due to an increase in the average balance of our interest bearing liabilities to \$2.6 billion from \$1.9 billion, and an increase in the average cost of funds to 4.35% from 3.17% primarily due to increased borrowings under certain credit facilities with higher interest rates, interest related to the subordinated notes, and the accelerated amortization of \$3.6 million of deferred fees recognized in connection with the payoff of our corporate credit facility during the nine months ended September 30, 2015.

**Net interest margin.** Net interest margin decreased to 2.35% for the nine months ended September 30, 2015 from 3.24% for the nine months ended September 30, 2014. The decrease in net interest margin was primarily due to an increase in our average cost of interest bearing liabilities and the accelerated amortization of deferred fees. The net interest spread, the difference between gross yield on our interest earning assets and the total cost of our interest bearing liabilities, decreased to 1.52% from 2.45%.

The following table summarizes the yield and cost of interest earning assets and interest bearing liabilities for the nine months ended September 30, 2015 and 2014:

	Nine Months Ended September 30, 2015 (\$ in thousands)			Nine Months Ended September 30, 2014		
	Interest	Average		Interest	Average	
	Average	Income/	Yield/	Average	Income/	Yield/
	Balance	Expense	Cost	Balance	Expense	Cost
Total interest earning assets	\$3,214,755	\$141,241	5.87 %	\$2,515,976	\$105,838	5.62 %
Total interest bearing liabilities	2,602,713	84,764	4.35 %	1,890,302	44,830	3.17 %
Net interest spread		\$56,477	1.52 %		\$61,008	2.45 %

Net interest margin	2.35 %	3.24 %
---------------------	--------	--------

Provision for credit losses. The provision for credit losses decreased \$7.1 million to \$14.7 million for the nine months ended September 30, 2015 from \$21.8 million for the nine months ended September 30, 2014. The decrease in the provision was primarily due to a decrease of \$12.7 million in specific provisions recorded during the nine months ended September 30, 2015 as compared to nine months ended September 30, 2014, partially offset by an increase of \$5.6 million of general provisions, which was primarily a result of loan growth. During the nine months ended September 30, 2015, we recorded net specific provisions for impaired loans of \$7.1 million compared to \$19.7 million recorded during the nine months ended September 30, 2014. The net specific component of the provision for credit losses was primarily focused around negative credit migration related to one previously identified impaired loan.

Non-interest income. Non-interest income increased \$3.3 million, to \$15.0 million for the nine months ended September 30, 2015 from \$11.7 million on a consolidated basis for the nine months ended September 30, 2014. For the nine months ended September 30, 2015, non-interest income was primarily comprised of \$10.5 million of fee income comprised primarily of capital markets fees, such as arrangement, syndication and advisory fees, \$3.0 million of asset management fees, \$1.7 million of unused fees, and \$0.5 million of income from sale of equipment at maturity of lease, a \$0.3 million of income from sale of loans, a \$1.0 million unrealized loss on a total return swap and \$0.5 million equity impairment. For the nine months ended September 30, 2014, non-interest income was primarily comprised of \$6.7 million of gains recognized from the sale of equity interests in certain impaired borrowers, \$2.0

million of fee income, \$2.1 million of income from other real estate owned properties, and \$1.5 million of equity method of accounting losses.

As a result of certain of our troubled debt restructurings, we have received equity interests in several of our impaired borrowers. The equity interests in certain impaired borrowers is initially recorded at fair value when the debt is restructured and is subsequently analyzed at the end of each quarter. In situations where we are deemed to be under the equity method of accounting, we record our ownership share of the borrowers' results of operations in non-interest income. Additionally, our corresponding share of our borrowers' results of operations may directly impact the remaining net book value of these respective loans. These equity interests may give rise to potential capital gains or losses, for tax purposes. This could impact future period tax rates depending on our ability to recognize capital losses to the extent of any capital gains.

Operating expenses. Operating expenses increased \$0.1 million, to \$35.1 million for the nine months ended September 30, 2015 from \$35.0 million on a consolidated basis for the nine months ended September 30, 2014. Compensation and benefits expense increased \$0.7 million and general and administrative expenses decreased \$0.7 million.

Income taxes. For the nine months ended September 30, 2015 and 2014, we provided for income taxes based on an effective tax rate of approximately 42% and 41%, respectively.

## FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity consist of cash flow from operations, credit facilities, term debt securitizations and proceeds from equity and debt offerings. We believe that these sources will be sufficient to fund our current operations, lending activities and other short-term liquidity needs. Subject to market conditions, we continue to explore opportunities for the Company to increase its leverage, including through the issuance of high yield debt securities, convertible debt securities, share repurchases, secured or unsecured senior debt or revolving credit facilities, to support loan portfolio growth and/or strategic acquisitions, which may be material to us. In addition to opportunistic funding related to potential growth initiatives, our future liquidity needs will be determined primarily based on prevailing market and economic conditions, the credit performance of our loan portfolio and loan origination volume. We may need to raise additional capital in the future based on various factors including, but not limited to: faster than expected increases in the level of non-accrual loans; lower than anticipated recoveries or cash flow from operations; and unexpected limitations on our ability to fund certain loans with credit facilities. We may not be able to raise debt or equity capital on acceptable terms or at all. The incurrence of additional debt will increase our leverage and interest expense, and the issuance of any equity or securities exercisable, convertible or exchangeable into Company common stock may be dilutive for existing shareholders.

During the third quarter of 2015, the U.S. economy showed mixed signals which, taken as a whole, we believe point toward continued gradual economic growth in the short-to-medium term. The third quarter saw positive signals in consumer spending and disposable income, and housing market conditions showed signs of continued gradual improvement. Neutral signals were shown in wages and unemployment, and negative signals were seen in manufacturing and business equipment spending. The Fed has continued to maintain it will act carefully to keep interest rates low until the economy is strong and recently stated it would need to see sufficient progress in the job market and would raise rates when voters were reasonably confident that inflation would rise back to the 2% target. We expect stable trends and moderate growth in the U.S. to continue and monetary policy to remain conducive to gradual growth in the near term. We expect Treasury and investment grade bond rates remain relatively low and investors to continue to focus on allocating capital to riskier, higher yielding, fixed and floating rate asset classes in order to generate additional yield from their investments. The larger, more liquid segments of the securitization

markets continued to display strong volume and pricing and conditions in the securitization market for loans (the CLO market) remain attractive for issuers such as NewStar, despite some lingering uncertainty surrounding regulatory changes. We believe that the CLO market, which the Company partially relies upon for funding, has stabilized to a point that it will provide a reliable source of capital for companies like NewStar. In addition to these signs of stabilizing market conditions, we believe the Company has substantially greater financial flexibility and increased financing options due to our market experience and improvement in our financial performance.

We believe that our ability to access the capital markets, secure new credit facilities, and renew and/or amend our existing credit facilities continues to demonstrate an overall improvement in the market conditions for funding and indicates progress in our ability to obtain financings on improved terms in the future. Despite these signs of improving market conditions and relative stability in recent years, we cannot assure these conditions will continue, and it is possible that the financial markets could experience stress, volatility, and/or illiquidity. If they do, we could face materially higher financing costs and reductions in leverage, which would affect our operating strategy and could materially and adversely affect our financial condition.

#### Cash and Cash Equivalents

As of September 30, 2015 and December 31, 2014, we had \$57.5 million and \$33.0 million, respectively, in cash and cash equivalents. We may invest a portion of cash on hand in short-term liquid investments. From time to time, we may use a portion of our

unrestricted cash to pay down our credit facilities creating undrawn capacity which may be redrawn to meet liquidity needs in the future.

#### Restricted Cash

Separately, we had \$140.9 million and \$95.4 million of restricted cash as of September 30, 2015 and December 31, 2014, respectively. The restricted cash represents the balance of the principal and interest collections accounts and pre-funding amounts in our credit facilities, our term debt securitizations and customer holdbacks and escrows. The use of the principal collection accounts' cash is limited to funding the growth of our loan and portfolio within the facilities or paying down related credit facilities or term debt securitizations. As of September 30, 2015, we could use \$15.5 million of restricted cash to fund new or existing loans. The interest collection account cash is limited to the payment of interest, servicing fees and other expenses of our credit facilities and term debt securitizations and, if either a ratings downgrade or failure to receive ratings confirmation occurs on the rated notes in a term debt securitization at the end of the funding period or if coverage ratios are not met, paying down principal with respect thereto. Cash to fund the growth of our loan portfolio and to pay interest on our term debt securitizations represented a large portion of our restricted cash balance at September 30, 2015.

#### Cash Collateral on Deposit with Custodian

We had \$53.7 million and \$38.9 million of cash collateral posted with custodians at September 30, 2015 and December 31, 2014, respectively. These amounts represent cash posted as collateral to enhance the credit quality of the underlying referenced portfolio of loans in our total return swap and repurchase agreements. At September 30, 2015, we had \$51.8 million posted against our TRS with Citibank, \$1.8 million posted against our JP Morgan Chase Bank repurchase agreement and \$0.1 million posted against our Citibank Global Markets repurchase agreement. At December 31, 2014, the \$38.9 million cash collateral was posted against our TRS with Citibank. The amount of cash posted as collateral under these credit agreements will vary from time to time as the market value of the underlying assets fluctuate with the change in the market.

#### Investment in Debt Securities, Available- for- Sale

The fair value of investment in debt securities, available for sale is based on quoted prices received from third-parties. Our investment in debt securities, available for sale are considered Level 1. During the nine months ended September 30, 2015, we purchased \$85.0 million of investment in debt securities available-for-sale compared to \$5.0 million of investment in debt securities available-for-sale for the same period in 2014. During the nine months ended September 30, 2015, we had \$33.0 million of investment in debt securities redeemed at par, compared to \$6.0 million redeemed at par for the same period in 2014. During the nine months ended September 30, 2015 and 2014, we did not sell any investment in debt securities available-for-sale.

At September 30, 2015, the fair value of investment in debt securities, available for sale was \$94.3 million with a net unrealized loss of \$5.2 million, compared to a fair value of \$46.9 million and an unrealized gain of \$0.1 million at December 31, 2014.

As a result of our evaluation of the securities, we concluded that the unrealized losses at September 30, 2015 and December 31, 2014 were caused by changes in market prices driven by interest rates and credit spreads. Our evaluation of impairment include quotes from third parties, adjustments to prepayment speeds, delinquency, an analysis of expected cash flows, interest rates, market discount rates, other contract terms, and the timing and level of losses on the loans and leases within the underlying trusts. At September 30, 2015, we determined that it is not more likely than not that we will be required to sell the securities before we recover the amortized cost basis in the security. We have also determined that there has not been an adverse change in the cash flows expected to be collected. Based

upon our impairment review process, and our ability and intent to hold these securities until maturity or a recovery of fair value, the decline in the value of these investments is not considered to be “Other Than Temporary.”

#### Loans-Held-for-Sale

Loans classified as held-for-sale consist of loans originated by us and intended to be sold to third parties (including credit funds managed by the Company). At September 30, 2015 loans held-for-sale, consisted of \$431.8 million of leveraged finance loans.

These loans are carried at the lower of aggregate cost, net of any deferred origination costs or fees, or market value.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

As of September 30, 2015 and December 31, 2014, loans held-for-sale consisted of the following:

	September 30,	December 31,
	2015	2014
	(\$ in thousands)	
Leveraged Finance	\$431,811	\$202,369
Gross loans held-for-sale	431,811	202,369
Deferred loan fees, net	(4,393 )	(1,800 )
Total loans held-for-sale, net	\$427,418	\$200,569

At September 30, 2015, loans held-for-sale include loans with an aggregate outstanding balance of \$429.7 million that were intended to be sold to credit funds managed by the Company.

#### Asset Quality and Allowance for Loan and Lease Losses

If a loan is 90 days or more past due, or if management believes it is probable we will be unable to collect contractual principal and interest in the normal course of business, it is our policy to place the loan on non-accrual status. If a loan financed by a term debt securitization is placed on non-accrual status, the loan may remain in the term debt securitization and excess interest spread cash distributions to us will cease until cash accumulated in the term debt securitization equals the outstanding balance of the non-accrual loan, or if an overcollateralization test is present, excess interest spread cash is diverted, and used to de-lever the securitization to bring the ratio back into compliance, if the overcollateralization ratio is/was previously out of compliance with the target. When a loan is on non-accrual status, accrued interest previously recognized as interest income subsequent to the last cash receipt in the current year will be reversed, and the recognition of interest income on that loan will stop until factors indicating doubtful collection no longer exist and the loan has been brought current. We may make exceptions to this policy if the loan is well secured and is in the process of collection. As of September 30, 2015, we had impaired loans and leases with an aggregate outstanding balance of \$201.2 million. Impaired loans with an aggregate outstanding balance of \$160.4 million have been restructured and classified as troubled debt restructurings. Impaired loans with an aggregate outstanding balance of \$107.7 million were on non-accrual status. During the nine months ended September 30, 2015, we had charge-offs totaling \$4.0 million of impaired loans. Impaired loans of \$20.1 million were greater than 60 days past due and classified as delinquent. During the nine months ended September 30, 2015, we recorded \$7.1 million of net specific provisions for impaired loans. Included in our specific allowance for impaired loans was \$1.7 million related to delinquent loans.

We closely monitor the credit quality of our loans and leases which are partly reflected in our credit metrics such as loan delinquencies, non-accruals, and charge-offs. Changes to these credit metrics are largely due to changes in economic conditions and seasoning of the loan and lease portfolio.

We have provided an allowance for loan and lease losses to provide for probable losses inherent in our loan and lease portfolio. Our allowance for loan and lease losses as of September 30, 2015 and December 31, 2014 was \$53.1 million and \$43.0 million, respectively, or 1.72% and 1.81% of loans and leases, gross, respectively. As of September 30, 2015, we also had a \$1.4 million allowance for unfunded commitments, resulting in an allowance for credit losses of 1.76%.



The allowance for credit losses is based on a review of the appropriateness of the allowance for credit losses and its two components on a quarterly basis. The estimate of each component is based on observable information and on market and third-party data believed to be reflective of the underlying credit losses being estimated.

It is the Company's policy that during the reporting period to record a specific provision for credit losses for all loans which we have identified impairments. Subsequently, we may charge-off the portion of the loan for which a specific provision was recorded. All of these loans are classified as impaired (if they have not been so classified already as a result of a troubled debt restructuring) and are disclosed in the Allowance for Credit Losses footnote to the financial statements.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

Activity in the allowance for loan losses for the nine months ended September 30, 2015 and for the year ended December 31, 2014 was as follows:

	Nine Months	
	Ended	Year Ended
	September 30, 2015	December 31, 2014
	(\$ in thousands)	
Balance as of beginning of period	\$42,983	\$ 41,403
General provision for loan and lease losses	6,987	4,779
Specific provision for loan losses	7,074	22,070
Net charge offs	(3,932 )	(25,269 )
Balance as of end of period	53,112	42,983
Allowance for losses on unfunded loan commitments	1,369	710
Allowance for credit losses	\$54,481	\$ 43,693

During the nine months ended September 30, 2015 we recorded a total provision for credit losses of \$14.7 million. The Company decreased its allowance for credit losses to 1.76% of gross loans at September 30, 2015 compared to 1.84% at December 31, 2014.

#### Borrowings and Liquidity

As of September 30, 2015 and December 31, 2014, we had outstanding borrowings totaling \$3.1 billion and \$2.2 billion, respectively. Borrowings under our various credit facilities and term debt securitizations are used to partially fund our positions in our loan portfolio.

As of September 30, 2015 our funding sources, maximum debt amounts, amounts outstanding and unused debt capacity, subject to certain covenants and conditions, are summarized below:

Funding Source	Maximum		Unused	
	Debt	Amounts	Debt	
	Amount	Outstanding	Capacity	Maturity
	(\$ in thousands)			
Credit facilities	\$1,140,000	\$625,595	\$514,405	2015-2020
Term debt securitizations(1)	1,894,944	1,890,944	4,000	2022-2027
Repurchase agreements	137,640	137,640	—	2017
Senior notes	300,000	300,000	—	2020
Subordinated notes	300,000	250,000	50,000	2024
Total	\$3,772,584	\$3,204,179	\$568,405	

(1) Maturities for term debt are based on contractual maturity dates. Actual maturities may occur earlier.

We must comply with various covenants. The breach of certain of these covenants could result in a termination event and the exercise of remedies if not cured. At September 30, 2015, we were in compliance with all such covenants. These covenants are customary and vary depending on the type of facility. These covenants include, but are not limited to, failure to service debt obligations, failure to meet liquidity covenants and tangible net worth covenants, and failure to remain within prescribed facility portfolio delinquency, charge-off levels, and overcollateralization tests. In addition, we are required to make termination or make-whole payments in the event that certain of our existing credit facilities are prepaid. These termination or make-whole payments, if triggered, could be material to us individually or in the aggregate, and in the case of certain facilities, could be caused by factors outside of our control, including as a result of loan prepayment by the borrowers under the loan facilities that collateralize these credit facilities.

#### Credit Facilities

As of September 30, 2015 we had five credit facilities through certain of our wholly-owned subsidiaries: (i) a \$475 million credit facility with syndicated lenders agented by Wells Fargo Bank, National Association (“Wells Fargo”) to fund leveraged finance loans, (ii) a \$250 million credit facility with Citibank, N.A. (“Citibank”) to fund leveraged finance loans, (iii) a \$175 million credit facility with syndicated lenders agented by DZ Bank AG Deutsche Zentral-Genossenschaftsbank Frankfurt (“DZ Bank”) to fund asset-based loans, (iv) a \$165 million credit facility with a syndicate of lenders agented by Wells Fargo to fund asset-based loans, and (v) a \$75 million credit facility with Wells Fargo to fund equipment leases and loans.

We have a \$475.0 million credit facility with syndicated lenders agented by Wells Fargo to fund leveraged finance loans. The credit facility had an outstanding balance of \$216.1 million and unamortized deferred financing fees of \$6.9 million as of September 30, 2015. On August 10, 2015, we entered into an amendment to this facility which, among other things, increased the commitment amount to \$475.0 million and extended the maturity date to August 10, 2020. Interest on this facility accrued at a variable rate per annum. The facility provides for a revolving reinvestment period which ends on August 10, 2018 with a two-year amortization period.

We have a \$250.0 million credit facility with Citibank to fund leveraged finance loans. The credit facility had an outstanding balance of \$208.0 million and unamortized deferred financing fees of \$1.7 million as of September 30, 2015. On August 5, 2015, we entered into an amendment to this facility which, among other things, increased the commitment amount to \$250.0 million. Interest on this facility accrues at a variable rate per annum. The facility provides for a revolving reinvestment period which ends on May 5, 2018, with a two-year amortization period.

We have a \$175.0 million credit facility with syndicated lenders agented by DZ Bank that had an outstanding balance of \$104.0 million and unamortized deferred financing fees of \$1.3 million as of September 30, 2015. On June 19, 2015, we entered into an amendment to this facility which, among other things, increased the commitment amount to \$175.0 million, and extended the maturity date to June 30, 2018. Interest on this facility accrues at a variable rate per annum. As part of the agreement, there is a minimum interest charge of \$2.5 million per annum. If the facility is not utilized to cover this minimum requirement, then a make-whole fee is assessed to satisfy the minimum requirement. We are permitted to use the proceeds of borrowings under the credit facility to fund advances under asset-based loan commitments. The commitment amount under the credit facility provides for reinvestment until it matures on June 30, 2018 with no amortization period.

We have a \$165.0 million credit facility with syndicated lenders agented by Wells Fargo to fund asset-based loan origination. The credit facility had an outstanding balance of \$97.5 million and unamortized deferred financing fees of \$0.9 million as of September 30, 2015. On June 19, 2015, we entered into an amendment to this facility which, among other things, increased the commitment amount to \$165.0 million. The credit facility may be increased to an amount up to \$300.0 million subject to lender approval and other customary conditions. Interest on this facility accrues at a variable rate per annum. The credit facility provides for reinvestment until it matures on December 7, 2017 with no amortization period.

We have a note purchase agreement with Wells Fargo under the terms of which Wells Fargo agreed to provide a \$75.0 million credit facility to fund equipment leases and loans. The credit facility had no outstanding balance and unamortized deferred financing fees of \$1.0 million as of September 30, 2015. Interest on this facility accrues at a variable rate per annum. On April 10, 2015, we entered into an amendment to this facility which, among other things, extended the reinvestment period to April 10, 2017 and the final maturity date to April 10, 2019, and modified certain concentration amounts and specified threshold amounts.

#### Senior notes

On April 22, 2015, we completed the offering of senior notes consisting of \$300 million aggregate principal amount of our 7.25% Senior Notes due 2020 (the "2020 Notes"). We subsequently repaid in full our corporate credit facility with Fortress Credit Corp. with a portion of the net proceeds from this offering. The 2020 Notes mature on May 1, 2020, and bear interest at a rate of 7.25% per annum, which is payable semi-annually on May 1 and November 1 of each year, beginning November 1, 2015. At any time prior to May 1, 2017, we may redeem up to 35% of the aggregate principal amount of the 2020 Notes with the net cash proceeds of certain public equity offerings at a price equal to 107.25% of the aggregate principal amount so redeemed, plus accrued and unpaid interest thereon, provided that immediately following the redemption, at least 65% of the 2020 Notes that were originally issued remain outstanding and any such redemption occurs within 180 days following the closing of any such public equity offering. Additionally, at any time prior to May 1, 2017, we may redeem some or all of the 2020 Notes at a price equal to 100% of the aggregate principal amount, plus accrued and unpaid interest thereon and a make-whole premium. On or after

May 1, 2017, we may redeem the 2020 Notes, in whole or in part, at redemption prices specified in the 2020 Notes plus accrued and unpaid interest thereon. In addition, if we undergo a change of control, we will be required to make an offer to purchase each holder's 2020 Notes at a price equal to 101% of the principal amount of the 2020 Notes, plus accrued and unpaid interest. As of September 30, 2015 unamortized deferred financing fees were \$6.2 million.

We must comply with certain covenants and restrictions related to the 2020 Notes. Subject to certain exceptions as detailed therein, the indenture relating to the 2020 Notes restricts our ability to incur additional Non Funding Indebtedness (as defined in the indenture) but permits the incurrence of indebtedness if on the date of such incurrence and after giving pro forma effect thereto (including pro forma application of the proceeds thereof), our Consolidated Non-Funding Debt to Equity Ratio (together with our Restricted Subsidiaries) is not greater than 1.75 to 1.00. Consolidated Non-Funding Debt to Equity Ratio is defined, with respect to any person on any determination date, as the ratio of Consolidated Non-Funding Debt (as defined in the indenture) of such person as of such determination date to the Consolidated Stockholders Equity (as defined in the indenture) of such person as of such determination date. If we fail to comply with this and certain other covenants included in the senior notes indenture, it could constitute an event of default that could result in the acceleration of the payment of the aggregate principal amount of 2020 Notes then

outstanding and accrued interest. At September 30, 2015 and currently, we were in compliance with all such covenants under the 2020 Notes indenture.

#### Subordinated notes

On December 4, 2014, we completed the initial closing of an investment of long-term capital from funds sponsored by Franklin Square Capital Partners ("Franklin Square") and sub-advised by GSO Capital Partners. The Franklin Square funds purchased \$200.0 million of 10-year subordinated notes (the "Subordinated Notes") that rank junior to the Company's existing and future senior debt, during the three months ended September 30, 2015, the Company drew an additional \$50 million of Subordinated Notes. The Company is required to borrow the remaining \$50.0 million of notes in increments of \$25.0 million by December 4, 2015, \$25.0 million of which was drawn in October 2015. The Subordinated Notes were recorded at par less the initial relative fair value of the warrants issued in connection with the investment on December 4, 2014 and January 23, 2015 (see Note 8) which was \$43.2 million as of December 31, 2014 and \$60.1 million as of September 30, 2015. The debt discount will amortize over the life of the notes and will be recorded as non-cash interest expense as the Subordinated Notes accrete to par value. As of September 30, 2015, unamortized deferred financing fees were \$5.7 million. The Subordinated Notes bear interest at 8.25% and include a Payment-in-Kind ("PIK Toggle") feature that allows the Company, at its option, to elect to have interest accrued at a rate of 8.75% added to the principal of the Subordinated Notes instead of paying it in cash. The Subordinated Notes have a ten year term and mature on December 4, 2024. They are callable during the first three years with payment of a make-whole premium. The prepayment premium decreases to 103% and 101% after the third and fourth anniversaries of the closing, respectively. They are callable at par after December 4, 2019. The Subordinated Notes require a mandatory payment at the end of each accrual period, beginning on December 5, 2019. The Company is required to make a cash payment of principal plus accrued interest in an amount required to prevent the Subordinated Notes from being treated as an "Applicable High Yield Discount Obligation" within the meaning of Section 163(i)(1) of the Internal Revenue Code of 1986, as amended. Events of default under the Subordinated Notes include failure to pay interest or principal when due subject to applicable grace periods, material uncured breaches of the terms of the Subordinated Notes, and bankruptcy/insolvency events.

We are subject to certain covenants for so long as Franklin Square holds at least \$50 million aggregate principal amount of Subordinated Notes. During this period, (i) the percentage of our gross revenue derived from investment and asset management fees in any fiscal year may not exceed 15% of our gross revenues for such fiscal year and (ii) we may not incur or permit any subsidiary of ours to incur any Indebtedness (as defined in the Investment Agreement related to the Subordinated Notes), if on the date of such incurrence and after giving effect thereto on a pro forma basis, our Total Leverage Ratio would be greater than 5.50 to 1.00. Total Leverage Ratio is defined as the ratio of (i) all of our Indebtedness and the Indebtedness of our consolidated subsidiaries, except for Indebtedness of non-majority owned finance subsidiaries and the Subordinated Notes and other pari passu subordinated debt to (ii) our shareholders' equity plus the Subordinated Notes and such other pari passu subordinated debt.

#### Term Debt Securitizations

In June 2007, we completed a term debt securitization transaction. In conjunction with this transaction we established a separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Trust 2007-1 (the "2007-1 CLO Trust") and sold and contributed \$600 million in loans and investments (including unfunded commitments), or portions thereof, to the 2007-1 CLO Trust. We remain the servicer of the loans. Simultaneously with the initial sale and contribution, the 2007-1 CLO Trust issued \$546.0 million of notes to institutional investors. We retained \$54.0 million, comprising 100% of the 2007-1 CLO Trust's trust certificates. At September 30, 2015, the \$185.3 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$239.3 million. At September 30, 2015, deferred financing fees were expensed in full. The 2007-1 CLO Trust permitted reinvestment of collateral principal repayments for a six-year period which ended in May 2013. During 2012, we purchased \$0.2 million of the 2007-1 CLO Trust's Class C notes. During 2010, we purchased \$5.0 million of the 2007-1 CLO Trust's Class D notes. During 2009, we purchased

\$1.0 million of the 2007-1 CLO Trust's Class D notes.

During 2009, Moody's downgraded all of the notes of the 2007-1 CLO Trust. As a result of the downgrade, amortization of the 2007-1 CLO Trust changed from pro rata to sequential, resulting in scheduled principal payments thereafter made in order of the notes seniority until all available funds are exhausted for each payment.

We receive a loan collateral management fee and excess interest spread. We also receive payments with respect to the classes of notes we own in accordance with the transaction documents. We expect to receive a principal distribution as owner of the trust certificates when the term debt is retired. If loan collateral in the 2007-1 CLO Trust is in default under the terms of the indenture, the excess interest spread from the 2007-1 CLO Trust would not be distributed until the undistributed cash plus recoveries equals the outstanding balance of the defaulted loan or if we elected to remove the defaulted collateral.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

The following table sets forth selected information with respect to the 2007-1 CLO Trust:

	Notes	Outstanding balance September 30, 2015	Borrowing spread to LIBOR	Ratings (S&P/Moody's/ Fitch)(1)
(\$ in thousands)				
<b>2007-1 CLO Trust</b>				
Class A-1	\$336,500	\$ 62,346	0.24	% AAA/Aaa/AAA
Class A-2	100,000	19,612	0.26	% AAA/Aaa/AAA
Class B	24,000	24,000	0.55	% AA+/Aa1/AA
Class C	58,500	58,293	1.30	% A-/A2/A
Class D	27,000	21,000	2.30	% BBB-/Baa2/BBB+
Total notes	546,000	185,251		
Class E (trust certificates)	29,100	29,100	N/A	CCC-/Ba3/BB
Class F (trust certificates)	24,900	24,900	N/A	N/A
Total for 2007-1 CLO Trust	\$600,000	\$ 239,251		

(1) These ratings were initially given in June 2007, are unaudited and are subject to change from time to time. On December 18, 2012, we completed a term debt securitization transaction. In conjunction with this transaction we established a separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2012-2 LLC (the "2012-2 CLO") and sold and contributed \$325.9 million in loans and investments (including unfunded commitments), or portions thereof, to the 2012-2 CLO. We remain the servicer of the loans. Simultaneously with the initial sale and contribution, the 2012-2 CLO issued \$263.3 million of notes to institutional investors. We retained \$62.6 million, comprising 100% of the 2012-2 CLO's membership interests, Class E notes, Class F notes, and subordinated notes. On June 12, 2015, we sold 100% of the 2012-2 CLO's Class E Notes totaling \$16.3 million to institutional investors. At September 30, 2015, the \$279.6 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$325.9 million. At September 30, 2015, deferred financing fees were \$1.6 million. The 2012-2 CLO permits reinvestment of collateral principal repayments for a three-year period ending in January 2016. Should we determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes.

We receive a loan collateral management fee and excess interest spread. We also receive payments with respect to the classes of notes we own in accordance with the transaction documents. We expect to receive a principal distribution as owner of the membership interests when the term debt is retired. If loan collateral in the 2012-2 CLO is in default under the terms of the indenture, the excess interest spread from the 2012-2 CLO may not be distributed if the overcollateralization ratio, or other collateral quality tests, is not satisfied.

The following table sets forth selected information with respect to the 2012-2 CLO:

Notes	Outstanding	Borrowing	Ratings
-------	-------------	-----------	---------



Edgar Filing: NewStar Financial, Inc. - Form 10-Q

	originally	balance	spread to	(Moody's/S&P)
	issued	September	LIBOR	(1)
		30, 2015		
	(\$ in thousands)			
<b>2012-2 CLO</b>				
Class A	\$ 190,700	\$ 190,700	1.90	% Aaa/AAA
Class B	26,000	26,000	3.25	% Aa2/N/A
Class C	35,200	35,200	4.25	% A2/N/A
Class D	11,400	11,400	6.25	% Baa2/N/A
Class E	16,300	16,300	6.75	% Ba1/N/A
Total notes	279,600	279,600		
Class F	24,100	24,100	N/A	B2/N/A
Subordinated notes	22,183	22,183	N/A	N/A
Total for 2012-2 CLO	\$ 325,883	\$ 325,883		

(1) These ratings were initially given in December 2012, are unaudited and are subject to change from time to time. On September 11, 2013, we completed a term debt securitization transaction through our separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2013-1 LLC (the "2013-1 CLO") and sold and contributed \$247.6 million in

loans and investments (including unfunded commitments), or portions thereof, to the 2013-1 CLO. We remain the servicer of the loans. Simultaneously with the initial sale and contribution, the 2013-1 CLO issued \$338.6 million of notes to institutional investors. We retained \$61.4 million, comprising 100% of the 2013-1 CLO's membership interests, Class F notes, Class G notes, and subordinated notes. At September 30, 2015, the \$334.6 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$396.0 million. At September 30, 2015, deferred financing fees were \$3.8 million. The 2013-1 CLO permits reinvestment of collateral principal repayments for a three-year period ending in September 2016. Should we determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes.

We receive a loan collateral management fee and excess interest spread. We also receive payments with respect to the classes of notes we own in accordance with the transaction documents. We expect to receive a principal distribution as owner of the membership interests when the term debt is retired. If loan collateral in the 2013-1 CLO is in default under the terms of the indenture, the excess interest spread from the 2013-1 CLO may not be distributed if the overcollateralization ratio, or other collateral quality tests, is not satisfied.

The following table sets forth selected information with respect to the 2013-1 CLO:

Notes	Outstanding balance originally issued (\$ in thousands)	September 30, 2015	Borrowing spread to LIBOR	Ratings (S&P/Moody's) (2)
<b>2013-1 CLO</b>				
Class A-T	\$202,600	\$ 202,600	1.65	% AAA/Aaa
Class A-R	35,000	31,000	(1	) AAA/Aaa
Class B	38,000	38,000	2.30	% AA/N/A
Class C	36,000	36,000	3.80	% A/N/A
Class D	21,000	21,000	4.55	% BBB/N/A
Class E	6,000	6,000	5.30	% BBB-/N/A
Total notes	338,600	334,600		
Class F	17,400	17,400	N/A	N/A
Class G	15,200	15,200	N/A	N/A
Subordinated notes	28,800	28,800	N/A	N/A
Total for 2013-1 CLO	\$400,000	\$ 396,000		

(1)Class A-R Notes accrue interest at the Class A-R CP Rate so long as they are held by a CP Conduit, and otherwise will accrue interest at the Class A-R LIBOR Rate or, in certain circumstances, the Class A-R Base Rate, but in no event shall interest rate payable pari passu with the Class A-T Notes exceed the Class A-R Waterfall Rate Cap.

(2)These ratings were initially given in September 2013, are unaudited and are subject to change from time to time. On April 17, 2014, we completed a term debt securitization transaction through our separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2014-1 LLC (the "2014-1 CLO") and sold and contributed \$249.6 million in loans and investments (including unfunded commitments), or portions thereof, to the 2014-1 CLO. We remain the servicer of the loans. Simultaneously with the initial sale and contribution, the 2014-1 CLO issued \$289.5 million of notes to institutional investors. We retained \$58.9 million, comprising 100% of the

2014-1 CLO's membership interests, Class E notes, Class F notes, and subordinated notes. At September 30, 2015, the \$289.5 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$348.4 million. At September 30, 2015, deferred financing fees were \$2.7 million. The 2014-1 CLO permits reinvestment of collateral principal repayments for a four-year period ending in April 2018. Should we determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes.

We receive a loan collateral management fee and excess interest spread. We also receive payments with respect to the classes of notes we own in accordance with the transaction documents. We expect to receive a principal distribution as owner of the membership interests when the term debt is retired. If loan collateral in the 2014-1 CLO is in default under the terms of the indenture, the excess interest spread from the 2014-1 CLO may not be distributed if the overcollateralization ratio, or other collateral quality tests, is not satisfied.

The following table sets forth selected information with respect to the 2014-1 CLO:

Notes	Outstanding balance originally issued September 30, 2015 (\$ in thousands)	Borrowing spread to LIBOR	Ratings (Moody's) (2)
<b>2014-1 CLO</b>			
Class A	\$202,500	\$ 202,500	1.80 % Aaa
Class B-1	20,000	20,000	2.60 % Aa2
Class B-2	13,250	13,250	(1 ) Aa2
Class C	30,250	30,250	3.60 % A2
Class D	23,500	23,500	4.75 % Baa3
Total notes	289,500	289,500	
Class E	18,500	18,500	N/A N/A
Class F	14,000	14,000	N/A N/A
Subordinated notes	26,375	26,375	N/A N/A
Total for 2014-1 CLO	\$348,375	\$ 348,375	

(1) Class B-2 Notes accrue interest at a fixed rate of 4.902%.

(2) These ratings were initially given in April 2014, are unaudited and are subject to change from time to time. On March 20, 2015, we completed a term debt securitization transaction through our separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2015-1 LLC (the "2015-1 CLO") and sold and contributed \$336.3 million in loans and investments (including unfunded commitments), or portions thereof, to the 2015-1 CLO. We remain the servicer of the loans. Simultaneously with the initial sale and contribution, the 2015-1 CLO issued \$410.3 million of notes to institutional investors. We retained \$85.8 million, comprising 100% of the 2015-1 CLO's membership interests and subordinated notes. At September 30, 2015, the \$410.3 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$496.1 million. At September 30, 2015, deferred financing fees were \$4.1 million. The 2015-1 CLO permits reinvestment of collateral principal repayments for a four-year period ending in April 2019. Should we determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes.

We receive a loan collateral management fee and excess interest spread. We also receive payments with respect to the classes of notes it owns in accordance with the transaction documents. We expect to receive a principal distribution as owner of the membership interests when the term debt is retired. If loan collateral in the 2015-1 CLO is in default under the terms of the indenture, the excess interest spread from the 2015-1 CLO may not be distributed if the overcollateralization ratio, or if other collateral quality tests, are not satisfied.

The following table sets forth selected information with respect to the 2015-1 CLO:

Notes	Outstanding	Borrowing	Ratings
-------	-------------	-----------	---------

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

	originally	balance	spread to	(Moody's/Fitch)
	issued	September	LIBOR	(2)
		30, 2015		
	(\$ in thousands)			
<b>2015-1 CLO</b>				
Class A-1	\$253,500	\$ 253,500	1.80	% Aaa/AAA
Class A-2	35,000	35,000	(1	) Aaa/AAA
Class B	50,000	50,000	2.80	% Aa2/ N/A
Class C	38,500	38,500	3.85	% A2/N/A
Class D	33,250	33,250	5.50	% Baa3/N/A
Total notes	410,250	410,250		
Subordinated notes	85,815	85,815	N/A	N/A
Total for 2015-1 CLO	\$496,065	\$ 496,065		

(1) Class A-2 Notes accrue interest at a spread over Libor of 1.65% from the closing date to, but excluding March 20, 2017, and 2.00% thereafter.

(2) These ratings were initially given in March 2015, are unaudited and are subject to change from time to time.

56

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

On September 1, 2015, NewStar Equipment Finance I, LLC, our subsidiary, completed a static asset-backed securitization transaction through a separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Lease Funding 2015-1 LLC (the “2015-1 ABS”) and sold and contributed \$100.1 million in leases and equipment loans (including unfunded commitments), or portions thereof, to the 2015-1 ABS. We remain the servicer of the leases and equipment loans. Simultaneously with the initial sale and contribution, the 2015-1 ABS issued \$70.0 million of notes to institutional investors. We retained all of the 2015-1 ABS’s membership interest and the Class B notes, totaling \$40.6 million. At September 30, 2015, the \$64.0 million of outstanding drawn notes were secured by cash, leases and equipment loans totaling \$104.6 million. At September 30, 2015, deferred financing fees were \$1.3 million.

We receive a collateral management fee and excess interest spread. We also receive payments with respect to the classes of notes we own in accordance with the transaction documents. We expect to receive a principal distribution as owner of the membership interests when the term debt is retired. If loan collateral in the 2015-1 ABS is in default under the terms of the indenture, the excess interest spread may not be distributed if the target overcollateralization ratio, or other performance based tests, are not satisfied.

The following table sets forth selected information with respect to the 2015-1 ABS:

	Notes originally issued (\$ in thousands)	Outstanding balance September 30, 2015	Borrowing spread to LIBOR	Ratings (DBRS) (1)
<b>2015-1 ABS</b>				
Class A	\$70,046	\$ 63,993	3.27%	AA
Total notes	70,046	63,993		
Class B (retained)	12,809	12,809	5.43%	A/(low)
Subordinated notes	27,755	27,755	N/A	N/A
Total for 2015-1 ABS	\$110,610	\$ 104,557		

(1) These ratings were initially given in September 2015, are unaudited and are subject to change from time to time.

On September 15, 2015, we completed a term debt securitization transaction through our separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2015-2 LLC (the “2015-2 CLO”) and sold and contributed \$298.4 million in loans and investments (including unfunded commitments), or portions thereof, to the 2015-2 CLO. We remain the servicer of the loans. Simultaneously with the initial sale and contribution, the 2015-2 CLO issued \$327.8 million of notes to institutional investors. We retained \$70.1 million, comprising 100% of the 2015-2 CLO’s membership interests and a portion of the Class E notes. At September 30, 2015, the \$327.8 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$397.8 million. At September 30, 2015, deferred financing fees were \$4.1 million. The 2015-2 CLO permits reinvestment of collateral principal repayments for a four-year period ending in August 2019. Should we determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes.

We receive a loan collateral management fee and excess interest spread. We also receive payments with respect to the classes of notes we own in accordance with the transaction documents. We expect to receive a principal distribution as owner of the membership interests when the term debt is retired. If loan collateral in the 2015-2 CLO is

in default under the terms of the indenture, the excess interest spread from the 2015-2 CLO may not be distributed if the overcollateralization ratio, or other collateral quality tests, are not satisfied.

The following table sets forth selected information with respect to the 2015-2 CLO:

	Notes	Outstanding balance September 30, 2015	Borrowing spread to LIBOR	Ratings (Moody's/Fitch) (2)
	(\$ in thousands)			
<b>2015-2 CLO</b>				
Class A-1	\$205,000	\$205,000	2.00	% Aaa/AAA
Class A-2	23,000	23,000	(1 )	Aaa/AAA
Class B	40,000	40,000	2.90	% Aa2/ N/A
Class C	26,250	26,250	3.95	% A2/N/A
Class D	28,500	28,500	5.25	% Baa3/N/A
Class E	5,000	5,000	7.50	% Ba3/N/A
Total notes	327,750	327,750		
Class E (retained)	23,250	23,250	7.50	% Ba3/N/A
Subordinated notes	46,806	46,806	N/A	N/A
Total for 2015-2 CLO	\$397,806	\$397,806		

(1) Class A-2 Notes accrue interest at a fixed rate of 3.461%.

(2) These ratings were initially given in August 2015, are unaudited and are subject to change from time to time.

#### Corporate Credit Facility

On January 5, 2010, we entered into a note agreement with Fortress Credit Corp., which was subsequently amended on August 31, 2010, January 27, 2012, November 5, 2012, and December 4, 2012. The agreement was amended and restated on May 13, 2013 and further amended on June 3, 2013. The credit facility, as amended, consisted of a \$238.5 million term note with Fortress Credit Corp. as agent, which consisted of the existing outstanding balance of \$100.0 million (the "Existing Funding"), an initial funding of \$98.5 million (the "Initial Funding"), and three subsequent borrowings, of \$5.0 million (the "Delay Draw Term A"), \$25.0 million (the "Delay Draw Term B") and the \$10.0 million Term C Loan. On April 22, 2015, we repaid in full the term note with Fortress Credit Corp.

#### Repurchase Agreements

On June 7, 2011, we entered into a five-year, \$68.0 million financing arrangement with Macquarie Bank Limited backed primarily by a portfolio of commercial mortgage loans previously originated by us. The financing was structured as a master repurchase agreement under which we sold the portfolio of commercial mortgage loans to Macquarie for an aggregate purchase price of \$68.0 million. We also agreed to repurchase the commercial mortgage loans from time to time (including a minimum quarterly amount), and agreed to repurchase all of the commercial mortgage loans by June 7, 2016. Upon the repurchase of a commercial mortgage loan, we are obligated to repay the principal amount related to such mortgage loan plus accrued interest (at a rate based on LIBOR plus a margin) to the date of repurchase. We will continue to service the commercial mortgage loans. On October 2, 2013, we entered into an amendment to this financing arrangement which, among other things, extended the date it had agreed to repurchase all of the commercial mortgage loans by one year to June 7, 2017, provided for \$25.5 million of additional advances for existing eligible assets owned by us, allowed for the advance of up to \$15.0 million to fund an additional



commercial mortgage loan, and released \$41.1 million of principal payments to us as unrestricted cash. The facility accrues interest at a variable rate per annum, which was 5.21% as of September 30, 2015. As of September 30, 2015, unamortized deferred financing fees were \$0.6 million and the outstanding balance was \$42.4 million. During the nine months ended September 30, 2015, we made principal payments totaling \$14.8 million.

We entered into a repurchase transaction with Deutsche Bank AG, pursuant to the terms of a Global Master Repurchase Agreement (2000 version), dated as of February 13, 2015 between Deutsche Bank AG and NS Bond Funding I LLC (the “Deutsche Bank Repurchase Agreement”). Pursuant to the Deutsche Bank Repurchase Agreement, Deutsche Bank AG will purchase securities and simultaneously agree to sell the securities back to us at a specified date. Under the terms of the Deutsche Bank Repurchase Agreement, we are required at all times to maintain a level of overcollateralization for the obligations, which is maintained through daily margining. As of September 30, 2015, the outstanding balance was \$12.2 million. We have made certain representations and warranties and are required to comply with various covenants and requirements customary for financing arrangements of this nature.

We entered into a repurchase transaction with Citigroup Global Markets, pursuant to the terms of a Global Master Repurchase Agreement (2000 version), dated as of March 16, 2015 between Citigroup Global Markets and NS Loan Originator LLC (the "Citigroup Repurchase Agreement"). Pursuant to the Citigroup Repurchase Agreement, Citigroup Global Markets will purchase securities and simultaneously agree to sell the securities back to us at a specified date. Under the terms of the Citigroup Repurchase Agreement, we are required at all times to maintain a level of overcollateralization for the obligations, which is maintained through daily margining. As of September 30, 2015, the outstanding balance was \$15.2 million. We have made certain representations and warranties and are required to comply with various covenants and requirements customary for financing arrangements of this nature.

We entered into a repurchase transaction with JP Morgan Chase Bank pursuant to the terms of a Global Master Repurchase Agreement (2000 version), dated as of April 2, 2015 between JP Morgan Chase Bank and NS Bond Funding II LLC (the "JP Morgan Repurchase Agreement"). Pursuant to the JP Morgan Repurchase Agreement, JP Morgan Chase Bank will purchase securities and simultaneously agree to sell the securities back to us at a specified date. Under the terms of the JP Morgan Repurchase Agreement, we are required at all times to maintain a level of overcollateralization for the obligations, which is maintained through daily margining. As of September 30, 2015, the outstanding balance was \$67.8 million. We have made certain representations and warranties and are required to comply with various covenants and requirements customary for financing arrangements of this nature.

#### Stock Repurchase Program

On October 7, 2015, our Board of Directors authorized the repurchase of up to \$5 million of the Company's common stock from time to time in open market or in privately negotiated transactions. The timing and amount of any shares purchased will be determined by our management based on market conditions and other factors. This repurchase program will expire by its terms on March 31, 2016, unless extended by our Board of Directors, and may be suspended or discontinued at any time without notice.

As of September 30, 2015, we had completed the stock repurchase program approved on August 13, 2014 pursuant to which we repurchased 892,911 shares of our common stock at a weighted average price of \$11.20 per share. The August 2014 program authorized the repurchase of up to \$10.0 million of the Company's common stock from time to time on the open market or in privately negotiated transactions.

On March 24, 2015, the Company repurchased 1,000,000 shares of its common stock in a privately negotiated transaction with an unaffiliated third party for an aggregate purchase price of \$10.3 million.

On December 22, 2014, the Company repurchased 1,000,000 shares of its common stock in a privately negotiated transaction with an unaffiliated third party for an aggregate purchase price of \$10.2 million.

On May 5, 2014, the Company's Board of Directors authorized the repurchase of up to \$20.0 million of the Company's common stock from time to time on the open market or in privately negotiated transactions. The Company completed its repurchase program during July 2014. Under this stock repurchase program, the Company repurchased 1,519,615 shares of its common stock at a weighted average price per share of \$13.13.

#### DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

We maintain an overall risk management strategy that may incorporate the use of derivative instruments to minimize significant unplanned fluctuations in earnings caused by interest rate volatility. Our operations are subject to risks resulting from interest rate fluctuations on our interest-earning assets and our interest-bearing liabilities. We seek to provide maximum levels of net interest income, while maintaining acceptable levels of interest rate and liquidity risk. As such, we may enter into interest rate swap and interest rate cap agreements to hedge interest rate exposure to interest rate fluctuations on floating rate funding agreement liabilities that are matched with fixed rate securities. Under the interest rate swap contracts, we agree to exchange, at specified intervals, the difference between fixed and floating interest amounts calculated on an agreed-upon notional principal amount. We record the exchanged amount in net interest income in our statements of operations. Under the interest rate cap contracts, we agree to exchange, at specified intervals, the difference between a specified fixed interest (the cap) and floating interest amounts calculated on an agreed-upon notional principal amount, but only if the floating interest rate exceeds the cap rate. The interest rate caps may not be matched to specific assets or liabilities and would not qualify for hedge accounting.

Gains and losses on derivatives not designated as hedges, including any cash payments made or received, are reported as gain or (loss) on derivatives in our consolidated statements of operations.

## OFF BALANCE SHEET ARRANGEMENTS

We are party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our borrowers. These financial instruments include unfunded commitments and standby letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement we have in particular classes of financial instruments.

Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. We use the same credit policies in making commitments and conditional obligations as we do for on-balance sheet instruments.

Unused lines of credit are commitments to lend to a borrower if certain conditions have been met. These commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because certain commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate each borrower's creditworthiness on a case-by-case basis. The amount of collateral required is based on factors that include management's credit evaluation of the borrower and the borrower's compliance with financial covenants. Due to their nature, we cannot know with certainty the aggregate amounts that will be required to fund our unfunded commitments. The aggregate amount of these unfunded commitments currently exceeds our available funds and will likely continue to exceed our available funds in the future. At September 30, 2015, we had \$484.7 million of unused lines of credit.

Standby letters of credit are conditional commitments issued by us to guarantee the performance by a borrower to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending credit to our borrowers. At September 30, 2015 we had \$8.1 million of standby letters of credit.

In addition, we enter into derivative instruments and hedging activities from time to time that are not on our balance that also subject us to off-balance sheet risk.

On December 4, 2014, we entered into a total return swap ("TRS") for senior floating rate loans with Citibank, N.A. ("Citibank"). The TRS with Citibank enables us, through a wholly owned financing subsidiary NewStar TRS I LLC, to obtain the economic benefits of the loans subject to the TRS, despite the fact that such loans will not be directly owned by us, in return for an interest payment to Citibank. The underlying loan portfolio of the TRS is typically large, liquid broadly syndicated loans. We act as the manager of the TRS and select the specific loans to be subject to the TRS. The TRS does not qualify for hedge accounting treatment as it does not offset the risks of another investment position. The initial maximum market value (determined at the time such loan becomes subject to the TRS) of the portfolio of loans subject to the TRS was \$75.0 million. On March 2, 2015, we entered into an amendment to the TRS that increased the maximum value to \$150.0 million, and on July 14, 2015, we entered into an additional amendment to the TRS that increased the maximum value to \$175.0 million. Interest accrues at one-month LIBOR+1.60% per annum. We are required to cash collateralize a specified percentage of each loan included under the TRS in accordance with margin requirements

As of September 30, we had approximately \$162.6 million in loans, based on book value, held off balance sheet in this TRS, which constituted approximately 4.2% of our assets. These off-balance sheet loans are valued on a mark-to-market basis, using the midpoint of the bid-ask spread derived from Markit Loan Pricing Service. At September 30, 2015, the fair value of the underlying loan portfolio was \$160.8 million, resulting in the swap being in an unrealized loss position of \$1.8 million compared to an unrealized loss position of \$0.9 million at December 31, 2014.

This value of this portfolio is based on mark-to-market valuations of the underlying loans and is subject to period over period fluctuations; as such we may be subject to material fluctuations in our consolidated results of operations due to

unrealized gains or losses. In addition, unrealized losses in the TRS or other of our off-balance sheet obligations may be realized if we are in a loss position at the time of sale or other disposition.

As of September 30, 2015, we had cash collateral on deposit with Citibank of \$51.8 million. Our obligations under the TRS are non-recourse to us, and our exposure is limited to the value of the cash collateral, which from time to time will fluctuate based upon the market value of the underlying loans. Citibank may terminate the TRS on or after December 4, 2015, and we can terminate the TRS at any time upon providing 10 days notice, subject to a termination fee if terminated prior to December 4, 2015.

## CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared based on the application of accounting policies, the most significant of which are described in the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Note 2 to the consolidated financial statements included in the Company's 2014 Annual Report, as updated in Note 2 to the unaudited consolidated financial statements in this Quarterly Report. These policies require numerous estimates and assumptions, which may prove inaccurate or subject to variations. Changes in underlying factors, assumptions or estimates could have a material impact on the Company's future financial condition and results of operations. The most critical of these significant accounting policies are the policies for revenue recognition, allowance for credit losses, income taxes, stock compensation and valuation methodologies. As of the date of this report, the Company does not believe that there has been a material change in the nature or categories of its critical accounting policies or its estimates and assumptions from those discussed in its 2014 Annual Report.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We are exposed to changes in market values of our loans held-for-sale, which are carried at lower of cost or market, and our investment in debt securities, available-for-sale and derivatives, which are carried at fair value. Fair value is defined as the market price for those securities for which a market quotation is readily available and for all other investments and derivatives, fair value is determined pursuant to a valuation policy and a consistent valuation process. Where a market quotation is not readily available, we estimate fair value using various valuation methodologies, including cash flow analysis, as well as qualitative factors.

As of September 30, 2015 and December 31, 2014, investments in debt securities available-for-sale totaled \$94.3 million and \$46.9 million, respectively. At September 30, 2015 and December 31, 2014, our net unrealized gain (loss) on those debt securities totaled \$(5.2) million and \$0.01 million, respectively. Any unrealized gain or loss on these investments is included in Other Comprehensive Income in the equity section of the balance sheet, until realized.

Interest rate risk represents a market risk exposure to us. Interest rate risk is measured as the potential volatility to our net interest income caused by changes in market interest rates.

As of September 30, 2015, approximately 5% of the loans in our portfolio were at fixed rates and approximately 95% were at variable rates. Additionally, for the loans at variable rates, approximately 94% contain an interest rate floor. Our credit facilities and term debt securitizations all bear interest at variable rates without interest rate floors.

The presence of interest rate floors in our loan agreements results in assets with hybrid fixed and floating rate loan characteristics. Provided that the contractual interest rate remains at or below the interest rate floor, a performing loan will typically behave as a fixed rate instrument. If contractual interest rates are in excess of the interest rate floor, a performing loan will typically behave as a floating rate instrument. In a low interest rate environment, floors provide a benefit as we are able to earn additional income equal to the difference between the stated rate of the interest rate floor and the corresponding contractual rate. If interest rates rise, the potential benefit provided by interest rate floors would decrease resulting in lower net interest income. The cost of our variable rate debt would increase, while interest income from loans with interest rate floors would not change until interest rates exceed the stated rate of the interest rate floors or upon the re-pricing or principal repayment of the loans.

The following table shows the hypothetical estimated change in net interest income over a 12-month period based on a static, instantaneous parallel shift in interest rates applied to our portfolio and cash and cash equivalents as of

September 30, 2015. Our modeling is based on contractual terms and does not consider prepayment or changes in the composition of our portfolio or our current capital structure. It further generalizes that both variable rate assets and liabilities are indexed to a flat 3 month LIBOR yield curve. Although we believe these measurements are representative of our interest rate sensitivity, we can give no assurance that actual results would not differ materially from our modeled outcomes.

		Estimated Change
		in Net Interest
	Rate Change	Income Over
	(Basis Points)	12 Months
		(\$ in thousands)
Decrease of	100	\$ 21,300
Increase of	100	(12,250 )
Increase of	200	1,030
Increase of	300	10,550

The estimated changes in net interest income reflect the potential effect of interest rate floors on loans totaling approximately \$3.3 billion. Due to the presence of these interest rate floors, as interest rates begin to rise from current levels, the cost of our variable rate debt increases. The interest rate on performing loans will remain fixed until the contractual rate exceeds the stated rate on the interest rate floors. Consequently, the result is a negative net interest income impact as interest rates initially increase until they reach

an inflection point. Beyond this inflection point, which is typically close to the portfolios weighted average stated floor rate, the benefit of rising rates begins to accrue to us as the interest rate on performing loans starts to adjust upward.

#### Item 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the period covered by this Quarterly Report (the “Evaluation Date”). Based on this evaluation, our principal executive officer and principal financial officer concluded that, as of the Evaluation Date, these disclosure controls and procedures are effective.

##### Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) identified in connection with the evaluation of our internal control over financial reporting that occurred during the third quarter of 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

#### Item 1. Legal Proceedings.

From time to time we expect to be party to legal proceedings. We are not currently subject to any material legal proceedings.

#### Item 1A. Risk Factors.

There have been no material changes to the Company’s risk factors since our most recently filed Annual Report on Form 10-K, as amended, except as noted below.

We bear the risk of loss for our total return swap and other off balance sheet obligations.

The term “off-balance sheet risk” refers to an unrecorded potential liability that, even though it does not appear on our balance sheet, may result in future obligation or loss. We are party to financial instruments with off balance sheet risk in the normal course of business to meet the financing needs of our borrowers, including unfunded commitments and standby letters of credit. In addition, we enter into derivative instruments and hedging activities from time to time that are not on our balance that also subject us to off-balance sheet risk.



As of September 30, 2015, for example, we had approximately \$162.6 million in loans, based on book value, held off balance sheet in a total return swap, which constituted approximately 4.2% of our assets. These off-balance loans are valued on a mark-to-market basis, using the midpoint of the bid-ask spread derived from Markit Loan Pricing Service, and are subject period over period fluctuations. At September 30, 2015, the fair value of the underlying loan portfolio was \$160.8 million, resulting in the swap being in an unrealized loss position of \$1.8 million compared to an unrealized loss position of \$0.9 million at December 31, 2014.

Because certain of our loans are subject to period over period fluctuations due to mark-to-market valuations of the underlying loans, we may be subject to material fluctuations in our consolidated results of operations due to unrealized gains or losses. In addition, unrealized losses in our off-balance sheet obligations may be realized if we are in a loss position at the time of sale or other disposition.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table sets forth the repurchases we made for the three-month period ending on September 30, 2015:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or
	(1)(2)(3)	(1)(2)(3)	Programs	Programs
July 1-31, 2015	71,070	\$ 11.23	70,446	\$ -
August 1-31, 2015	294	11.69	-	-
September 1-30, 2015	441	8.61	-	-
Total: Three months ended September 30, 2015	71,805	\$ 11.22	70,446	-

- (1) The Company repurchased 70,446 shares during the period pursuant to the share repurchase program that we announced on August 13, 2014 (the “Repurchase Program”). Certain of these shares were repurchased on the open market pursuant to a trading plan under Rule 10b5-1 of the Exchange Act.
- (2) Includes an aggregate of 1,359 shares of Common Stock acquired from individuals in order to satisfy tax withholding requirements in connection with the vesting of restricted stock awards under equity compensation plans during the third quarter.
- (3) The Repurchase Program provided for the repurchase of up to \$10.0 million of the Company’s common stock from time to time on the open market or in privately negotiated transactions. The Company completed the Repurchase Program during July 2015.

Item 6. Exhibits.

Exhibit

Number	Description	Method of Filing
2(a)	Purchase Agreement, dated as of September 16, 2015, by and among the Company, Andrea S. Feingold, and R. Ian O’Keeffe.	Filed herewith.
3(a)	Amended and Restated Certificate of Incorporation of the Company.	Previously filed as Exhibit 3(a) to the Company’s Annual Report on Form 10-K for the year ended December 31, 2006, filed on April 2, 2007 (File No. 001-33211) and incorporated herein by reference.
3(b)	Amended and Restated Bylaws of the Company.	Previously filed as Exhibit 3(b) to the Company’s Annual Report on Form 10-K for the year ended December 31, 2006, filed on April 2, 2007 (File No. 001-33211) and incorporated herein by reference.
4(a)	Indenture by and between NewStar Commercial Lease Funding 2015-1 LLC, as Issuer, and Wells Fargo Bank, National Association as Trustee and Custodian, dated as of September 1, 2015.	Previously filed as Exhibit 4.1 to the Company’s Current Report on Form 8-K (File No. 001-33211) filed on September 3, 2015 and incorporated herein by reference.
4(b)	Indenture by and between NewStar Commercial Loan Funding 2015-2 LLC, as Issuer, and U.S. Bank National Association, as Trustee, dated as of September 15, 2015.	Previously filed as Exhibit 4.1 to the Company’s Current Report on Form 8-K (File No. 001-33211) filed on September 21, 2015 and incorporated herein by reference.
10(a)	First Amendment to Loan and Servicing Agreement dated as of August 5, 2015, by and among NewStar Warehouse Funding I, LLC, the Company, and Citibank, N.A.	Previously filed as Exhibit 10.1 to the Company’s Current Report on Form 8-K (File No. 001-33211) filed on August 7, 2015 and incorporated herein by reference.
10(b)	Sixth Amended and Restated Loan and Servicing Agreement, dated as of August 10, 2015, by and among NewStar CP Funding LLC, the Company, Wells Fargo Bank, National Association, Wells Fargo Securities, LLC, US. Bank National Association, and certain lenders from time to time party thereto.	Previously filed as Exhibit 10.1 to the Company’s Current Report on Form 8-K (File No. 001-33211) filed on August 13, 2015 and incorporated herein by reference.
10(c)	Purchase and Contribution Agreement by and between NewStar Equipment Finance I, LLC, as seller and NewStar Commercial Lease Funding 2015-1 LLC, as purchaser, dated as of September 1, 2015.	Previously filed as Exhibit 10.1 to the Company’s Current Report on Form 8-K (File No. 001-33211) filed on September 3, 2015 and incorporated herein by reference.
10(d)		

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

	Master Loan Sale Agreement by and among the Company, as Transferor, NewStar Commercial Loan Depositor 2015-2 LLC, as Retention Holder, and NewStar Commercial Loan Funding 2015-2 LLC, as Issuer, dated as of September 15, 2015.	Previously filed as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 001-33211) filed on September 21, 2015 and incorporated herein by reference.
10(e)	Collateral Management Agreement by and between the Company, as Collateral Manager, and NewStar Commercial Loan Funding 2015-2 LLC, as Issuer, dated as of September 15, 2015.	Previously filed as Exhibit 10.2 to the Company's Current Report on Form 8-K (File No. 001-33211) filed on September 21, 2015 and incorporated herein by reference.
31(a)	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith.
31(b)	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith.
32 64	Certifications pursuant to 18 U.S.C. Section 1350.	Filed herewith.

---

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

Exhibit

Number	Description	Method of Filing
101	The following materials from the Quarterly Report of NewStar Financial, Inc. on Form 10-Q for the quarter ended September 30, 2015, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014, (ii) Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2015 and 2014, (iii) Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2015 and 2014, (iv) Condensed Consolidated Statements of Changes in Stockholders' Equity for the nine months ended September 30, 2015 and 2014, (v) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and 2014, and (vi) Notes to the Condensed Consolidated Financial Statements.	Filed herewith.
101.INS	XBRL Instance Documents	
101.SCH	XBRL Taxonomy Extension Schema Document	
101.CAL	XBRL Calculation Linkbase Document	
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	
101.LAB	XBRL Label Linkbase Document	
101.PRE	XBRL Taxonomy Presentation Linkbase Document	

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.

NEWSTAR FINANCIAL, INC.

Date: November 5, 2015 By: /S/ JOHN KIRBY BRAY  
John Kirby Bray  
Chief Financial Officer

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

Exhibit Number	Description	Method of Filing
2(a)	Purchase Agreement, dated as of September 16, 2015, by and among the Company, Andrea S. Feingold, and R. Ian O’Keeffe.	Filed herewith.
3(a)	Amended and Restated Certificate of Incorporation of the Company.	Previously filed as Exhibit 3(a) to the Company’s Annual Report on Form 10-K for the year ended December 31, 2006, filed on April 2, 2007 (File No. 001-33211) and incorporated herein by reference.
3(b)	Amended and Restated Bylaws of the Company.	Previously filed as Exhibit 3(b) to the Company’s Annual Report on Form 10-K for the year ended December 31, 2006, filed on April 2, 2007 (File No. 001-33211) and incorporated herein by reference.
4(a)	Indenture by and between NewStar Commercial Lease Funding 2015-1 LLC, as Issuer, and Wells Fargo Bank, National Association as Trustee and	Previously filed as Exhibit 4.1 to the Company’s Current Report on Form 8-K (File No. 001-33211) filed on September 3, 2015 and

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

- |       |  |  |
|-------|--|--|
|       | Custodian, dated as of September 1, 2015.  | incorporated herein by reference.  |
| 4(b)  | Indenture by and between NewStar Commercial Loan Funding 2015-2 LLC, as Issuer, and U.S. Bank National Association, as Trustee, dated as of September 15, 2015.  | Previously filed as Exhibit 4.1 to the Company's Current Report on Form 8-K (File No. 001-33211) filed on September 21, 2015 and incorporated herein by reference. |
| 10(a) | First Amendment to Loan and Servicing Agreement dated as of August 5, 2015, by and among NewStar Warehouse Funding I, LLC, the Company, and Citibank, N.A.   | Previously filed as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 001-33211) filed on August 7, 2015 and incorporated herein by reference.    |
| 10(b) | Sixth Amended and Restated Loan and Servicing Agreement, dated as of August 10, 2015, by and among NewStar CP Funding LLC, the Company, Wells Fargo Bank, National Association, Wells Fargo Securities, LLC, US. Bank National Association, and certain lenders from time to time party thereto. | Previously filed as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 001-33211) filed on August 13, 2015 and incorporated herein by reference.   |
| 10(c) | Purchase and Contribution  | Previously filed as Exhibit 10.1 to the  |



Edgar Filing: NewStar Financial, Inc. - Form 10-Q

- |       |   |   |
|-------|---|---|
|       | Agreement by and between NewStar Equipment Finance I, LLC, as seller and NewStar Commercial Lease Funding 2015-1 LLC, as purchaser, dated as of September 1, 2015.  | Company's Current Report on Form 8-K (File No. 001-33211) filed on September 3, 2015 and incorporated herein by reference.  |
| 10(d) | Master Loan Sale Agreement by and among the Company, as Transferor, NewStar Commercial Loan Depositor 2015-2 LLC, as Retention Holder, and NewStar Commercial Loan Funding 2015-2 LLC, as Issuer, dated as of September 15, 2015. | Previously filed as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 001-33211) filed on September 21, 2015 and incorporated herein by reference. |
| 10(e) | Collateral Management Agreement by and between the Company, as Collateral Manager, and NewStar Commercial Loan Funding 2015-2 LLC, as Issuer, dated as of September 15, 2015.   | Previously filed as Exhibit 10.2 to the Company's Current Report on Form 8-K (File No. 001-33211) filed on September 21, 2015 and incorporated herein by reference. |
| 31(a) | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   | Filed herewith.   |
| 31(b) | Certification of Chief Financial  | Filed herewith.   |

Officer pursuant to  
Section 302 of the  
Sarbanes-Oxley Act  
of 2002.

32      Certifications      Filed herewith.  
pursuant to 18  
U.S.C. Section  
1350.

Edgar Filing: NewStar Financial, Inc. - Form 10-Q

Exhibit	Description	Method of Filing
Number	Description	Filing
101	The following materials from the Quarterly Report of NewStar Financial, Inc. on Form 10-Q for the quarter ended September 30, 2015, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014, (ii) Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2015 and 2014, (iii) Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2015 and 2014, (iv) Condensed Consolidated Statements of Changes in Stockholders' Equity for the nine months ended September 30, 2015 and 2014, (v) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and 2014, and (vi) Notes to the Condensed Consolidated Financial Statements.	Filed herewith.
101.INS	XBRL Instance Documents	
101.SCH	XBRL Taxonomy Extension Schema Document	
101.CAL	XBRL Calculation Linkbase Document	
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	
101.LAB	XBRL Label Linkbase Document	
101.PRE	XBRL Taxonomy Presentation Linkbase Document	

