

NEWTEK BUSINESS SERVICES INC

Form 10-Q

August 22, 2005

[Table of Contents](#)

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## SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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### FORM 10-Q

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(Mark One)

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

For the quarterly period ended June 30, 2005

OR

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

Commission File Number: 001-16123

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## NEWTEK BUSINESS SERVICES, INC.

(Exact name of registrant as specified in its charter)

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New York  
(State or other jurisdiction of)

11-3504638  
(I.R.S. Employer)

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incorporation or organization)

Identification No.)

100 Quentin Roosevelt Boulevard, Garden City, NY  
(Address of principal executive offices)

11530  
(Zip Code)

Registrant's telephone number, including area code: (516) 390-2260

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Check whether the registrant has (1) filed all documents and reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past ninety days. Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of August 11, 2005, 34,522,836 Common shares were issued and outstanding.

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**Table of Contents**

**CONTENTS**

|                                                                                                           | <b><u>PAGE</u></b> |
|-----------------------------------------------------------------------------------------------------------|--------------------|
| <br><b>PART I - FINANCIAL INFORMATION</b>                                                                 |                    |
| <u>Item 1. Financial Statements (Unaudited)</u>                                                           |                    |
| <u>Consolidated Balance Sheets as of June 30, 2005 and December 31, 2004</u>                              | 3                  |
| <u>Consolidated Statements of Income for the Three and Six Month Periods Ended June 30, 2005 and 2004</u> | 4                  |
| <u>Consolidated Statements of Cash Flows for the Six Month Periods Ended June 30, 2005 and 2004</u>       | 5                  |
| <u>Notes to Unaudited Consolidated Financial Statements</u>                                               | 7                  |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>      | 19                 |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>                                 | 27                 |
| <u>Item 4. Controls and Procedures</u>                                                                    | 28                 |
| <br><b>PART II - OTHER INFORMATION</b>                                                                    |                    |
| <u>Item 2. Unregistered Sale of Equity Securities and Use of Proceeds</u>                                 | 28                 |
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u>                                        | 29                 |
| <u>Item 5. Other Information</u>                                                                          | 30                 |
| <u>Item 6. Exhibits</u>                                                                                   | 30                 |
| <u>Signatures</u>                                                                                         | 32                 |
| Certifications                                                                                            |                    |
| Exhibits                                                                                                  |                    |

**Table of Contents****ITEM 1. FINANCIAL STATEMENTS****NEWTEK BUSINESS SERVICES, INC., AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****JUNE 30, 2005 (UNAUDITED) AND DECEMBER 31, 2004**

|                                                                                                                                                                | <b>June 30,</b> | <b>December 31,</b> |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|---------------------|
|                                                                                                                                                                | <b>2005</b>     | <b>2004</b>         |
|                                                                                                                                                                | <hr/>           | <hr/>               |
| <b><u>ASSETS</u></b>                                                                                                                                           |                 |                     |
| Cash and cash equivalents                                                                                                                                      | \$ 59,581,112   | \$ 50,921,982       |
| Restricted cash                                                                                                                                                | 2,237,642       | 2,181,675           |
| Credits in lieu of cash                                                                                                                                        | 90,932,129      | 88,883,335          |
| SBA loans receivable (net of reserve for loan losses of \$1,385,341 and \$1,621,259, respectively)                                                             | 31,950,251      | 34,186,047          |
| Accounts receivable (net of allowance of \$106,798 and \$72,062, respectively)                                                                                 | 1,794,514       | 1,561,252           |
| Receivable from bank                                                                                                                                           | 6,949,317       | 1,799,537           |
| SBA loans held for sale                                                                                                                                        | 3,623,374       | 2,262,035           |
| Accrued interest receivable                                                                                                                                    | 397,080         | 375,411             |
| Investments in qualified businesses cost method investments                                                                                                    | 300,000         | 300,000             |
| Investments in qualified businesses held to maturity debt investments                                                                                          | 3,998,947       | 2,909,097           |
| Structured insurance product                                                                                                                                   | 3,296,815       | 3,216,112           |
| Prepaid insurance                                                                                                                                              | 17,165,339      | 15,505,326          |
| Prepaid expenses and other assets (net of accumulated amortization of deferred financing costs and other intangibles of \$801,752 and \$404,105, respectively) | 6,673,668       | 4,708,865           |
| Servicing asset (net of accumulated amortization of \$934,178 and \$486,799, respectively)                                                                     | 2,673,823       | 2,084,763           |
| Furniture, fixtures and equipment (net of accumulated depreciation and amortization of \$1,630,857 and \$1,025,672, respectively)                              | 3,167,870       | 1,958,927           |
| Customer accounts (net of accumulated amortization of \$2,049,825 and \$1,226,741, respectively)                                                               | 6,528,755       | 4,393,226           |
| Goodwill                                                                                                                                                       | 7,892,508       | 11,150,326          |
|                                                                                                                                                                | <hr/>           | <hr/>               |
| Total assets                                                                                                                                                   | \$ 249,163,144  | \$ 228,397,916      |
|                                                                                                                                                                | <hr/>           | <hr/>               |
| <b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>                                                                                                             |                 |                     |
| Liabilities:                                                                                                                                                   |                 |                     |
| Accounts payable and accrued expenses                                                                                                                          | \$ 7,368,580    | \$ 9,725,690        |
| Notes payable certified investors                                                                                                                              | 3,935,619       | 3,925,946           |
| Notes payable insurance                                                                                                                                        | 9,340,861       | 7,877,195           |
| Notes payable other                                                                                                                                            | 8,014,464       | 520,000             |
| Bank notes payable                                                                                                                                             | 29,780,186      | 27,987,696          |
| Deferred revenue                                                                                                                                               | 1,286,137       | 1,160,286           |
| Notes payable in credits in lieu of cash                                                                                                                       | 86,776,311      | 76,258,728          |
| Mandatorily redeemable preferred stock                                                                                                                         |                 | 1,500,000           |
| Deferred tax liability                                                                                                                                         | 17,539,887      | 16,626,577          |
|                                                                                                                                                                | <hr/>           | <hr/>               |
| Total liabilities                                                                                                                                              | 164,042,045     | 145,582,118         |
|                                                                                                                                                                | <hr/>           | <hr/>               |
| Minority interest                                                                                                                                              | 5,314,566       | 5,720,950           |
|                                                                                                                                                                | <hr/>           | <hr/>               |

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## Commitments and contingencies

### Shareholders' equity:

Preferred stock (par value \$0.02 per share; authorized 1,000,000 shares, no shares issued and outstanding)

Common stock (par value \$0.02 per share; authorized 39,000,000 shares, issued and outstanding 34,290,854

and 33,873,333, not including 582,980 shares held in escrow)

|                            |             |             |
|----------------------------|-------------|-------------|
|                            | 685,817     | 677,467     |
| Additional paid-in capital | 54,485,645  | 52,858,400  |
| Unearned compensation      | (2,309,176) | (2,297,459) |
| Retained earnings          | 26,944,247  | 25,856,440  |

|                            |            |            |
|----------------------------|------------|------------|
| Total shareholders' equity | 79,806,533 | 77,094,848 |
|----------------------------|------------|------------|

|                                            |                |                |
|--------------------------------------------|----------------|----------------|
| Total liabilities and shareholders' equity | \$ 249,163,144 | \$ 228,397,916 |
|--------------------------------------------|----------------|----------------|

See accompanying notes to these unaudited consolidated financial statements

**Table of Contents****NEWTEK BUSINESS SERVICES, INC., AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)****FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2005, AND 2004**

|                                                                        | <b>THREE MONTHS ENDED</b> |              | <b>SIX MONTHS ENDED</b> |              |
|------------------------------------------------------------------------|---------------------------|--------------|-------------------------|--------------|
|                                                                        | <b>JUNE 30,</b>           |              | <b>JUNE 30,</b>         |              |
|                                                                        | <b>2005</b>               | <b>2004</b>  | <b>2005</b>             | <b>2004</b>  |
| Revenue:                                                               |                           |              |                         |              |
| Income from tax credits                                                | \$ 10,336,138             | \$ 7,024,520 | \$ 11,397,479           | \$ 9,048,045 |
| Electronic payment processing                                          | 7,509,259                 | 4,070,630    | 13,520,242              | 7,303,134    |
| Servicing fee and premium income                                       | 2,643,111                 | 2,141,745    | 3,456,076               | 3,254,112    |
| Web hosting                                                            | 2,661,962                 |              | 4,910,838               |              |
| Interest and dividend income                                           | 1,256,192                 | 1,042,215    | 2,329,325               | 2,071,163    |
| Other income                                                           | 1,322,567                 | 203,225      | 3,205,654               | 676,374      |
| Insurance commissions                                                  | 496,645                   |              | 717,744                 |              |
| Total revenue                                                          | 26,225,874                | 14,482,335   | 39,537,358              | 22,352,828   |
| Expenses:                                                              |                           |              |                         |              |
| Interest                                                               | 3,880,315                 | 3,478,022    | 7,577,606               | 7,242,797    |
| Payroll and consulting fees                                            | 4,214,500                 | 2,361,025    | 8,311,482               | 4,546,474    |
| Electronic payment processing costs                                    | 5,469,553                 | 3,031,143    | 9,950,627               | 5,132,129    |
| Professional fees                                                      | 1,800,542                 | 842,656      | 3,539,364               | 1,837,265    |
| Insurance                                                              | 742,700                   | 691,350      | 1,463,437               | 1,406,312    |
| Provision (net benefit) for loan losses                                | 450,435                   | (151,930)    | 1,101,197               | (47,249)     |
| Depreciation and amortization                                          | 1,183,900                 | 327,271      | 2,273,295               | 617,592      |
| Other                                                                  | 1,594,416                 | 1,106,139    | 3,554,437               | 2,009,394    |
| Total expenses                                                         | 19,336,361                | 11,685,676   | 37,771,445              | 22,744,714   |
| Income (loss) before minority interest, and provision for income taxes | 6,889,513                 | 2,796,659    | 1,765,913               | (391,886)    |
| Minority interest                                                      | 112,064                   | 310,267      | 371,921                 | 610,581      |
| Income before provision for income taxes                               | 7,001,577                 | 3,106,926    | 2,137,834               | 218,695      |
| Provision for income taxes                                             | (2,539,069)               | (1,273,839)  | (1,050,027)             | (89,665)     |
| Net income                                                             | \$ 4,462,508              | \$ 1,833,087 | \$ 1,087,807            | \$ 129,030   |
| Net income per share:                                                  |                           |              |                         |              |
| Basic                                                                  | \$ 0.13                   | \$ 0.07      | \$ 0.03                 | \$ 0.00      |
| Diluted                                                                | \$ 0.13                   | \$ 0.07      | \$ 0.03                 | \$ 0.00      |
| Weighted average common shares outstanding                             |                           |              |                         |              |
| Basic                                                                  | 33,962,371                | 26,773,791   | 33,927,394              | 26,624,960   |
| Diluted                                                                | 34,044,096                | 27,227,038   | 34,075,018              | 27,158,205   |

See accompanying notes to these unaudited consolidated financial statements.



**Table of Contents****NEWTEK BUSINESS SERVICES, INC., AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)****FOR THE SIX MONTHS ENDED JUNE 30, 2005 AND 2004**

|                                                                                                   | <u>2005</u>         | <u>2004</u>        |
|---------------------------------------------------------------------------------------------------|---------------------|--------------------|
| Cash flows from operating activities:                                                             |                     |                    |
| Net income                                                                                        | \$ 1,087,807        | \$ 129,030         |
| Adjustments to reconcile net income to net cash used in operating activities:                     |                     |                    |
| Income from tax credits                                                                           | (11,397,479)        | (9,048,045)        |
| Deferred income taxes                                                                             | 913,310             | 89,665             |
| Depreciation and amortization                                                                     | 2,273,295           | 617,592            |
| Provision (net benefit) for loan losses                                                           | 1,101,197           | (47,249)           |
| SBA loans originated for sale                                                                     | (24,300,289)        | (16,644,036)       |
| Proceeds from sale of SBA loans held for sale                                                     | 22,938,950          | 17,422,904         |
| Gain on sale of loans held for investment                                                         | (249,748)           | (638,340)          |
| Amortization of deferred loan origination fees, net                                               | (152,435)           | (24,655)           |
| Accretion of interest income                                                                      | (87,808)            | (87,808)           |
| Accretion of interest expense                                                                     | 6,066,878           | 5,884,294          |
| Stock compensation                                                                                | 870,267             | 750,887            |
| Minority interest                                                                                 | (371,921)           | (610,581)          |
| Equity in earnings in investee                                                                    | (748,851)           |                    |
| Changes in assets and liabilities, net of purchase price reallocation:                            |                     |                    |
| Prepaid insurance                                                                                 | (1,660,013)         | (805,020)          |
| Prepaid expenses and other assets, accounts receivable, receivable from bank and servicing assets | (8,364,639)         | (2,064,099)        |
| Accounts payable and accrued expenses                                                             | (1,744,023)         | (93,687)           |
| Net cash used in operating activities                                                             | <u>(13,825,502)</u> | <u>(5,169,148)</u> |
| Cash flows from investing activities:                                                             |                     |                    |
| Investment in qualified businesses- held to maturity debt investments                             | (2,590,800)         | (643,500)          |
| Return of investments held to maturity debt investments                                           | 1,500,950           | 808,204            |
| Purchase of furniture, fixtures and equipment                                                     | (1,439,137)         | (291,476)          |
| Purchase of customer merchant accounts                                                            | (876,708)           |                    |
| SBA Loans originated for investment                                                               | (7,892,601)         | (7,278,910)        |
| Proceeds from sale of SBA loans held for investment                                               | 6,313,430           | 17,660,740         |
| Payments received on SBA loans                                                                    | 3,115,953           | 4,257,512          |
| Distribution from investee                                                                        | 820,320             |                    |
| Other investments                                                                                 | (34,464)            | (215,410)          |
| Net cash (used in) provided by investing activities                                               | <u>(1,080,057)</u>  | <u>14,297,160</u>  |

See accompanying notes to these unaudited consolidated financial statements.

**Table of Contents****NEWTEK BUSINESS SERVICES, INC., AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)****FOR THE SIX MONTHS ENDED JUNE 30, 2005 AND 2004 (CONTINUED)**

|                                                                                                                                                  | <u>2005</u>          | <u>2004</u>          |
|--------------------------------------------------------------------------------------------------------------------------------------------------|----------------------|----------------------|
| Cash flows from financing activities:                                                                                                            |                      |                      |
| Proceeds from issuance of notes payable to certified investors                                                                                   | \$ 22,823,841        | \$ 10,895,850        |
| Cash paid for Coverage A (Syndication of Notes)                                                                                                  | (6,007,674)          | (2,149,684)          |
| Principal payments of note payable-insurance                                                                                                     | (1,691,969)          | (1,112,048)          |
| Proceeds from note payable- other                                                                                                                | 8,014,464            |                      |
| Repayments of note payable other                                                                                                                 | (520,000)            | (240,000)            |
| Repayments of mandatorily redeemable preferred stock                                                                                             | (1,500,000)          |                      |
| Change in restricted cash                                                                                                                        | (55,967)             | 46,683               |
| Net proceeds (repayments) from SBA bank notes payable                                                                                            | 1,792,490            | (14,331,794)         |
| Net proceeds from exercise of stock options                                                                                                      |                      | 566,319              |
| Net proceeds from issuance of common stock                                                                                                       | 712,504              | 1,401,592            |
|                                                                                                                                                  | <u>23,567,689</u>    | <u>(4,923,082)</u>   |
| Net cash provided by (used in) financing activities                                                                                              |                      |                      |
| Net increase in cash and cash equivalents                                                                                                        | 8,659,130            | 4,204,930            |
| Cash and cash equivalents beginning of period                                                                                                    | 50,921,982           | 33,444,611           |
|                                                                                                                                                  | <u>59,581,112</u>    | <u>37,649,541</u>    |
| Cash and cash equivalents end of period                                                                                                          |                      |                      |
|                                                                                                                                                  | <u>\$ 59,581,112</u> | <u>\$ 37,649,541</u> |
| <b>Supplemental disclosure of cash flow activities:</b>                                                                                          |                      |                      |
| Reduction of credits in lieu of cash and notes payable in credits in lieu of cash balances due to delivery of tax credits to Certified Investors | \$ 9,348,685         | \$ 9,488,464         |
|                                                                                                                                                  | <u>3,000,000</u>     | <u>3,000,000</u>     |
| Issuance of notes in partial payment for insurance                                                                                               |                      |                      |
| Issuance of warrant in connection with purchase of Coverage A Insurance                                                                          | \$                   | \$ 250,000           |
|                                                                                                                                                  | <u>2,081,905</u>     | <u>560,311</u>       |
| CrystalTech Final Purchase Price Allocations to Goodwill                                                                                         |                      |                      |
| Additions to customer accounts                                                                                                                   | \$ 2,081,905         | \$                   |
| Additions to intangibles                                                                                                                         | 560,311              |                      |
| Additions to furniture and fixtures                                                                                                              | 374,991              |                      |
| Deductions to goodwill                                                                                                                           | (3,257,818)          |                      |
| Net additions to assets and liabilities                                                                                                          | 240,611              |                      |
|                                                                                                                                                  | <u>\$</u>            | <u>\$</u>            |
| Net effect on purchase price                                                                                                                     |                      |                      |
| Acquisition of minority interest resulting in goodwill:                                                                                          |                      |                      |
| Newtek Business Services common stock issued                                                                                                     | \$                   | \$ 517,324           |
| Less: minority interest acquired                                                                                                                 |                      | 148,301              |
|                                                                                                                                                  | <u>\$</u>            | <u>\$ 369,023</u>    |
| Goodwill recognized                                                                                                                              |                      |                      |

See accompanying notes to these unaudited consolidated financial statements.

**Table of Contents**

**NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (Unaudited):**

**Basis of presentation and description of business**

The unaudited consolidated financial statements of Newtek Business Services, Inc. and Subsidiaries (the Company or Newtek) included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and include all wholly and majority owned subsidiaries, and several portfolio companies in which the certified capital companies own non-controlling minority interests, or those which Newtek is considered to be the primary beneficiary of (as defined under FIN 46 and FIN 46R). All inter-company balances and transactions have been eliminated in consolidation.

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

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

The unaudited consolidated financial statements of Newtek reflect, in the opinion of management, all adjustments necessary for a fair statement of financial position of Newtek at June 30, 2005, the results of operations for the three and six months ended June 30, 2005 and 2004 and its cash flows for the six months ended June 30, 2005 and 2004. Results of operations for the interim periods may not be representative of results to be expected for a full year. All adjustments are of a normal recurring nature.

Reference is made to the Company's Annual Report on Form 10-K, as amended filed with the Securities and Exchange Commission for the year ended December 31, 2004, for a complete set of financial statements and notes thereto including the Company's significant accounting policies.

The following is a summary of each Capco or Capco fund, state or jurisdiction of certification and date of certification:

| <u>Capco</u> | <u>State/Jurisdiction of Certification</u> | <u>Date of Certification</u> |
|--------------|--------------------------------------------|------------------------------|
| WA           | New York                                   | May 1998                     |
| WP           | Florida                                    | December 1998                |
| WI           | Wisconsin                                  | October 1999                 |

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|         |                      |               |
|---------|----------------------|---------------|
| WLA     | Louisiana            | October 1999  |
| WA II   | New York             | April 2000    |
| WNY III | New York             | December 2000 |
| WC      | Colorado             | October 2001  |
| WAP     | Alabama              | February 2004 |
| WDC     | District of Columbia | November 2004 |
| WNY IV  | New York             | December 2004 |
| WTX I   | Texas                | March 2005    |

During June 2005, Newtek funded its fourteenth Capco, Wilshire Texas Partners I, LLC (WTX I) for total certified capital of \$22,792,023.

## **Table of Contents**

The State of Louisiana has four capco funds which are all a part of and consolidated with the WLA Capco. The second, Wilshire Louisiana Partners II, LLC (WLPPII), and the third, Wilshire Louisiana Partners III, LLC (WLPPIII), were formed in October 2001, and October 2002, respectively. The fourth, Wilshire Louisiana Partners IV, LLC (WLPPIV) was formed in October 2003.

In general, the Capcos issue debt and equity instruments, ( Certified Capital ), to insurance company investors ( Certified Investors ). The Capcos then make targeted investments ( Investments in Qualified Businesses , as defined under the respective state or district statutes, or, Qualified Businesses ) with the Certified Capital raised, which in most cases may be majority-owned or primarily controlled by the Capcos after the investments are consummated (excluding investments made by the Louisiana Capco). Participation in each Capco program legally entitles the Capco to receive (or earn) tax credits from the state upon satisfying quantified, defined investment percentage thresholds and time requirements. In order for the Capcos to maintain their state-issued certifications, the Capcos must make Investments in Qualified Businesses in accordance with these requirements. These state requirements are mirrored in the limitations agreed to by each Capco in its written agreements with its Certified Investors and limit the activities of the Capcos to conducting the business of a Capco. Each Capco also has separate, legal contractual arrangements with the Certified Investors obligating the Capco to refrain from unauthorized activities, to use the proceeds from the notes only for Capco-authorized (i.e., qualified ) investments, and to pay interest on the aforementioned debt instruments.

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

### ***Restricted Cash***

Under the terms of an agreement between Newtek Small Business Finance, Inc. ( NSBF ) and DB Structured Products, Inc., ( Deutsche Bank ) all payments received from NSBF's borrowers are transferred into a restricted bank account. NSBF uses these funds to pay required principal and interest to the bank, amounts due to third party participants and certain other required payments. As of June 30, 2005 and December 31, 2004, restricted cash was \$2,237,642 and \$2,181,675, respectively.

Under the terms of the processing agreement between Universal Processing Services of WI (d/b/a Newtek Merchant Solutions of WI, NMS-WI ), and their primary processing bank, NMS-WI maintains a cash account as a reserve against chargeback losses. As processing fees are received by the processing banks, a certain percentage is allocated to the cash reserve account. Total restricted cash held at the processing bank at June 30, 2005 and December 31, 2004 totaled \$125,000 and is included in prepaid expenses and other assets in the consolidated balance sheets.

### ***Stock - Based Compensation***

The Company has elected to continue using Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, in accounting for employee stock options. With regard to stock options, no stock-based employee compensation cost is reflected in net income, as all options granted had an exercise price equal to the market value of the underlying common stock at the date of grant. Compensation expense on restricted shares granted to employees is measured at the fair market value on the date of grant and recognized in the consolidated statements of income on a pro-rata basis over the service period which approximates the vesting period.



**Table of Contents**

The following table summarizes the pro forma consolidated statements of income of the Company as though the fair value based accounting method in Statement of Financial Accounting Standard ( SFAS ) No. 148 Accounting for Stock-based Compensation-Transition and Disclosure-an amendment of SFAS 123 had been used in accounting for employee stock options.

|                                                                                                                                                       | Three Months Ended |              | Six Months Ended |            |
|-------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|--------------|------------------|------------|
|                                                                                                                                                       | June 30,           |              | June 30,         |            |
|                                                                                                                                                       | 2005               | 2004         | 2005             | 2004       |
| Net income, as reported                                                                                                                               | \$ 4,462,508       | \$ 1,833,087 | \$ 1,087,807     | \$ 129,030 |
| Add: Total stock based employee compensation expense recognized, net of related tax effects                                                           | 229,263            | 169,595      | 465,682          | 312,696    |
| Deduct: Total pro forma stock based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (469,660)          | (192,944)    | (543,225)        | (401,206)  |
| Pro forma net income                                                                                                                                  | \$ 4,222,111       | \$ 1,809,738 | \$ 1,010,264     | \$ 40,520  |
| Net income per share:                                                                                                                                 |                    |              |                  |            |
| Basic as reported                                                                                                                                     | \$ 0.13            | \$ 0.07      | \$ 0.03          | \$ 0.00    |
| Basic pro forma                                                                                                                                       | \$ 0.12            | \$ 0.07      | \$ 0.03          | \$ 0.00    |
| Diluted as reported                                                                                                                                   | \$ 0.13            | \$ 0.07      | \$ 0.03          | \$ 0.00    |
| Diluted pro forma                                                                                                                                     | \$ 0.12            | \$ 0.07      | \$ 0.03          | \$ 0.00    |

For the six months ended June 30, 2005 the weighted average fair value of the options granted was estimated on the date of grant using the Black Scholes model with the following assumptions: expected volatility range of 42-48%, risk-free interest rate of 1.98%, expected dividends of \$0 and an expected term of 1 year.

**Use of Estimates**

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

## **Table of Contents**

### ***New Accounting Pronouncements***

In May 2005, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standard ( SFAS ) No. 154, Accounting Changes and Error Corrections (SFAS 154), which replaces Accounting Principles Board Opinion (APB) No. 20 Accounting Changes, and SFAS No. 3 Reporting Changes in Interim Financial Statements. SFAS 154 changes the requirements for the accounting for and reporting of a change in accounting principle, and applies to all voluntary changes in accounting principles, as well as changes required by an accounting pronouncement in the unusual instance that it does not include specific transition provisions. Specifically, SFAS 154 requires retrospective application to prior periods financial statements, unless it is impracticable to determine the period-specific effects or the cumulative effect of the change. SFAS 154 does not change the transition provisions of any existing pronouncement. SFAS is effective for the Company for all accounting changes and corrections of errors made beginning January 1, 2006.

In April 2005, the FASB issued Interpretation ( FIN ) No. 47, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143 . This interpretation clarifies that an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. It also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN No. 47 is effective no later than the end of fiscal years ending after December 15, 2005. The Company does not believe that the adoption of FIN No. 47 will have a material impact on the Company's consolidated financial statements.

In April 2005, the Securities and Exchange Commission approved a new rule that delays the effective date of SFAS No. 123 (revised 2004), Share-Based Payments, which requires companies to expense the value of employee and director stock options and similar awards. SFAS 123 (R) is now effective January 1, 2006 for Newtek. The Company is currently evaluating the impact of SFAS 123 (R).

In March 2005, the FASB issued Interpretation No. 46 (R ) -5 ( FIN 46(R )-5 ), *Implicit Variable Interests under FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities* . FIN 46-(R ) is effective for the first reporting period beginning after March 3, 2005, however earlier application is permitted. The Company is currently evaluating the impact of FIN 46 (R ) .

### ***Reclassifications***

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

### **NOTE 2 COMMON STOCK:**

In the six months ended June 30, 2005, Newtek issued 47,233 common shares to employees for total stock compensation of approximately \$131,000. The Company issued 37,795 common shares to the board of directors for \$150,000 worth of services rendered. In addition, 4,000 common shares were issued in consideration for consulting services rendered, valued at approximately \$16,000. In connection with the funding of the Wilshire Texas Capco, 328,493 common shares (of which 122,493 common shares were issued to an insurance company and the remainder to certified investors) were issued for approximately \$713,000.



**Table of Contents****NOTE 3 - INVESTMENTS IN QUALIFIED BUSINESSES:**

The following table is a summary of investments as of June 30, 2005, shown separately between their debt and equity components, and all terms of each are summarized. The various interests that the Company acquires in its Qualified Businesses are accounted for under three methods: consolidation, equity method and cost method. The applicable accounting method is generally determined based on the Company's voting interest or the economics of the transaction if the investee is determined to be a variable interest entity.

The manner of accounting for an investment in a Qualified Business is determined based upon applicable accounting principles. These principles do not necessarily coincide with concepts of ownership or control contained in some of the Capco statutes and which impose various limitations on the degree to which a Capco may own or control a Qualified Business. For example, current Louisiana law prohibits a Capco from making an investment in a business with the intent to control the business, and Colorado and New York place percentage limitations on a Capco's level of ownership of a qualified businesses (among other requirements). Newtek's Capcos of course conform to all applicable requirements but these requirements do not necessarily control the accounting treatment appropriate for a particular investment.

The following is a summary of our non-consolidated investments at June 30, 2005:

**Debt Investments:**

|                                       |              |
|---------------------------------------|--------------|
| Debt investments at December 31, 2004 | \$ 2,909,097 |
| Debt issued                           | 2,590,800    |
| Return of principal                   | (1,500,950)  |
|                                       | <hr/>        |
| Debt investments at June 30, 2005     | \$ 3,998,947 |
|                                       | <hr/>        |

**Cost Investments:**

|                                       |            |
|---------------------------------------|------------|
| Cost investments at December 31, 2004 | \$ 300,000 |
| Return of capital                     |            |
| Investments made                      |            |
|                                       | <hr/>      |
| Cost investments at June 30, 2005     | \$ 300,000 |
|                                       | <hr/>      |

The Company has not guaranteed any obligation of these investees and the Company is not otherwise committed to provide further financial support for the investees. However, from time-to-time, the Company may decide to provide such additional financial support which, as of June 30, 2005, was assessed at zero. Should the Company determine that an impairment exists upon its periodic review, and it is deemed to be other than temporary, the Company will write down the recorded value of the asset to its estimated fair value and record a corresponding charge in the Company's consolidated statement of income.



**Table of Contents**

**NOTE 4- LOANS RECEIVABLE (NON-CAPCO)**

Below is a summary of the Small Business Administration ( SBA ) loan receivable balance, net of SBA loan loss reserves as of June 30, 2005:

|                                                              |               |
|--------------------------------------------------------------|---------------|
| Balance at December 31, 2004                                 | \$ 34,186,047 |
| SBA loans originated for investment                          | 8,177,626     |
| Payments received                                            | (3,115,953)   |
| SBA loans held for investment, reclassified as held for sale | (6,063,682)   |
| Provision for SBA loan losses                                | (1,101,197)   |
| Deferred loan origination costs, net                         | (132,590)     |
|                                                              | <hr/>         |
| Balance at June 30, 2005                                     | \$ 31,950,251 |
|                                                              | <hr/>         |

Below is a summary of the reserve for loan losses balance as of June 30, 2005:

|                               |              |
|-------------------------------|--------------|
| Balance at December 31, 2004  | \$ 1,621,259 |
| Provision for SBA loan losses | 1,101,197    |
| Recoveries                    | 33,622       |
| Loan charge-offs              | (1,370,737)  |
|                               | <hr/>        |
| Balance at June 30, 2005      | \$ 1,385,341 |
|                               | <hr/>        |

Below is a summary of the SBA loans held for sale as of June 30, 2005:

|                                                              |              |
|--------------------------------------------------------------|--------------|
| Balance at December 31, 2004                                 | \$ 2,262,035 |
| Loan originations for sale                                   | 24,300,289   |
| SBA loans held for investment, reclassified as held for sale | 6,063,682    |
| Loans sold                                                   | (29,002,632) |
|                                                              | <hr/>        |
| Balance at June 30, 2005                                     | \$ 3,623,374 |
|                                                              | <hr/>        |

Below is a summary of the servicing asset as of June 30, 2005:

|                              |              |
|------------------------------|--------------|
| Balance at December 31, 2004 | \$ 2,084,763 |
| Servicing rights capitalized | 1,036,439    |
| Servicing rights amortized   | (447,379)    |
| Valuation allowance          | 0            |
|                              | <hr/>        |

|                          |              |
|--------------------------|--------------|
| Balance at June 30, 2005 | \$ 2,673,823 |
|--------------------------|--------------|

**Table of Contents**

The unpaid principal amount of loans serviced for others of approximately \$174,420,000 and \$157,380,000 at June 30, 2005 and December 31, 2004, respectively, is not included on the accompanying consolidated balance sheets.

All loans are priced at the prime interest rate plus approximately 2.75% to 3.75%. The only loans with a fixed interest rate are defaulted loans that are repurchased from the secondary market by the SBA. As of June 30, 2005 and December 31, 2004, the portion of NSBF's net loans receivable with adjustable interest rates was approximately \$33,103,000 and \$35,178,000, respectively.

As of June 30, 2005 and December 31, 2004 approximately \$34,748,000 and \$36,297,000, respectively, of loans, including loans held for sale, made by NSBF are pledged as collateral against the outstanding balances on NSBF's existing lines of credit.

Accruing loans past due ninety days or more as of June 30, 2005 and December 31, 2004 amounted to approximately \$0.

As of June 30, 2005 and December 31, 2004, total impaired non-accrual loans amounted to approximately \$2,847,000 and \$2,791,000, respectively. Approximately \$357,000 and \$507,000 of the allowance for loan losses were allocated against such impaired non-accrual loans, respectively, in accordance with SFAS No. 114.

The following is a summary of SBA loans receivable at:

|                                      | June 30,<br>2005 | December 31,<br>2004 |
|--------------------------------------|------------------|----------------------|
| Due in one year or less              | \$ 4,452         | \$ 240,686           |
| Due between one and five years       | 540,278          | 967,742              |
| Due after five years                 | 34,073,940       | 35,749,364           |
| Total                                | 34,618,670       | 36,957,792           |
| Less : Allowance for loan losses     | (1,385,343)      | (1,621,259)          |
| Less: Deferred origination fees, net | (1,283,076)      | (1,150,486)          |
| Balance                              | \$ 31,950,251    | \$ 34,186,047        |

*Sale of loans*

In June 2005, NSBF sold approximately \$6,064,000 of loans previously classified as held for investment for aggregate proceeds of approximately \$6,314,000. This represented a portion of the unguaranteed piece of 95 loans. The difference of \$250,000 was recorded as premium income. Also included in premium income is approximately \$337,000 representing the allocated portion of the remaining deferred loan origination costs.

**NOTE 5 EARNINGS PER SHARE:**

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

**Table of Contents**

The calculations of net income per share were:

|                                                                               | Three Months Ended |               | Six Months Ended |               |
|-------------------------------------------------------------------------------|--------------------|---------------|------------------|---------------|
|                                                                               | June 30,           |               | June 30,         |               |
|                                                                               | 2005               | 2004          | 2005             | 2004          |
| <b>Numerator:</b>                                                             |                    |               |                  |               |
| Numerator for basic and diluted EPS - income available to common stockholders | \$ 4,462,508       | \$ 1,833,087  | \$ 1,087,807     | \$ 129,030    |
| <b>Denominator:</b>                                                           |                    |               |                  |               |
| Denominator for basic EPS weighted average shares                             | 33,962,371         | 26,773,791    | 33,927,394       | 26,624,960    |
| Effect of dilutive securities                                                 | 81,725             | 453,247       | 147,623          | 533,245       |
| Denominator for diluted EPS weighted average shares                           | \$ 34,044,096      | \$ 27,227,038 | \$ 34,075,017    | \$ 27,158,205 |
| Net EPS: Basic                                                                | \$ 0.13            | \$ 0.07       | \$ 0.03          | \$ 0.00       |
| Net EPS: Diluted                                                              | \$ 0.13            | \$ 0.07       | \$ 0.03          | \$ 0.00       |

The following equity instruments are excluded from above as follows:

|                              | Three Months Ended |         | Six Months Ended |         |
|------------------------------|--------------------|---------|------------------|---------|
|                              | June 30,           |         | June 30,         |         |
|                              | 2005               | 2004    | 2005             | 2004    |
| Anti-dilutive stock options  | 1,474,835          | 463,887 | 1,239,835        | 458,511 |
| Restricted stock units       | 66,427             | 13,940  |                  | 19,316  |
| Warrants                     | 5,516              | 5,516   | 5,516            | 5,516   |
| Contingently issuable shares | 1,069,091          | 582,980 | 1,069,091        | 582,980 |

**NOTE 6 GOODWILL AND INTANGIBLES:**

During the six month period ended June 30, 2005, the Company finalized the purchase price allocation of the CrystalTech Web Hosting Inc., acquisition. The following summarizes the final fair values of the assets acquired and the liabilities assumed at the date of acquisition:

|                     |           |
|---------------------|-----------|
| Accounts receivable | \$ 68,000 |
| Customer accounts   | 4,382,000 |
| Trademark           | 550,000   |
| Software            | 483,000   |
| Non compete         | 11,000    |
| Goodwill            | 4,999,000 |
| Fixed assets        | 189,000   |

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|                                                           |                      |
|-----------------------------------------------------------|----------------------|
| Other assets                                              | 10,000               |
| <b>Total assets acquired</b>                              | <b>\$ 10,692,000</b> |
| Current liabilities (including accrued acquisition costs) | \$ 384,000           |
| Deferred revenues                                         | 802,000              |
| <b>Total liabilities assumed</b>                          | <b>1,186,000</b>     |
| <b>Purchase price, net of cash acquired</b>               | <b>\$ 9,506,000</b>  |

## **Table of Contents**

The difference between the aggregate purchase price and the fair value of the assets acquired and the liabilities assumed has been recorded as goodwill. Customer accounts, software and the non-compete are being amortized over a five year period. The trademark has an indefinite life, and accordingly is not being amortized. For the period ended June 30, 2005, amortization expense relating to the intangible assets totaled approximately \$483,000.

Also during the quarter ended June 30, 2005 one of our subsidiaries, First Bankcard Alliance, LLC, purchased customer merchant account portfolios for approximately \$692,000 in cash. The Company has allocated the entire purchase price to customer merchant accounts and is amortizing these accounts over an estimated useful life of 66 months. Total amortization related to such assets approximated \$32,000 and are included in the accompanying statements of income for the six months ended June 30, 2005. The Company is currently obtaining a valuation on this acquisition. In addition, the Company made smaller acquisitions of customer merchant accounts, aggregating \$185,000, and is amortizing these accounts over an estimated useful life of 66 months.

### **NOTE 7 NOTES PAYABLE-OTHER:**

CrystalTech entered into an agreement on March 28, 2005 with Technology Investment Capital Corp. ( TICC ) to borrow \$8 million to be repaid over 5 years maturing March 28, 2010 with a principal repayment of \$2 million due on March 28, 2008, \$3 million due on March 28, 2009 and March 28, 2010. Interest on the note is 10% for the first year, adjustable thereafter based on 6.35% plus the treasury rate (limited to a 1% increase or decrease in any one adjustment year) with a minimum interest rate of 8.5% and maximum of 12.0%. Newtek has agreed to pay TICC additional interest on each anniversary date of 2% of the average outstanding balance during the year in Newtek common shares. The loan can be prepaid without any penalty after 18 months. The note is collateralized by a first priority security interest in all the assets of CrystalTech. The note contains financial covenants, such as minimum revenues and minimum EBITDA thresholds. The Company has capitalized approximately \$431,000 of deferred financing costs, which will be amortized over a period of 5 years. Amortization expenses included in the accompanying statement of income for the three and six months ended June 30, 2005 totaled approximately \$22,000.

### **NOTE 8 BANK NOTES PAYABLE:**

In June 2004, NSBF executed an amendment to its existing credit agreement with Deutsche Bank whereby the \$75,000,000 line of credit was extended through June 2005. This amendment required NSBF to repurchase \$1,500,000 shares of Series A Preferred Stock on the earlier of a) the repayment in full of all obligations under the loan agreement and b) the termination date. In connection with the termination date on June 30, 2005 and the subsequent three month extension entered into on June 30, 2005, NSBF repurchased the \$1,500,000 in Series A Preferred Stock from Deutsche Bank.

### **NOTE 9 OTHER INCOME:**

Included in other income in the accompanying consolidated statements of income for the six months ended June 30, 2005 is a \$900,000 recovery from the Merchant Data Systems legal settlement and approximately \$749,000 of equity earnings from Exponential Business Development, L.P.

### **NOTE 10 SEGMENT REPORTING:**

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Operating segments are organized internally primarily by the type of services provided, and in accordance with SFAS No. 131, the Company has aggregated similar operating segments into four reportable segments, SBA lending, electronic payment processing, web hosting and Capcos and other.

The SBA lending segment is NSBF, a licensed, U.S. Small Business Administration (SBA) lender that originates, sells and services loans to qualifying small businesses, which are partially guaranteed by the SBA.

## **Table of Contents**

As an SBA lender, NSBF generates revenues from sales of loans, servicing income for those loans retained to service by NSBF (included in servicing fee and premium income on the unaudited consolidated statements of income) and interest income earned on available cash balances and the loans themselves. The lender also generates expenses such as interest, professional fees, payroll and consulting, and provision for loan losses, all of which are included in the respective caption on the consolidated statements of income. NSBF also has expenses such as loan recovery expenses, loan processing costs, depreciation and amortization, and other expenses that are all included in the other expense caption on the consolidated statements of income.

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

The web hosting segment consists of CrystalTech, acquired in July 2004. CrystalTech's revenues are derived primarily from web hosting services and set up fees. CrystalTech generates expenses such as professional fees, payroll and consulting, and depreciation and amortization which are included in the respective captions on the accompanying consolidated statements of income, as well as licenses and fees, and general office expenses, all of which are included in other expenses in the respective caption on the consolidated statements of income.

The Capcos and Other segment represents Newtek's activities in the certified capital company market as described in Note 1, as well as activities not included in the other three segments.

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

the nature of the product and services,

the type or class of customer for their products and services,

the methods used to distribute their products or provide their services, and

the nature of the regulatory environment, for example, banking, insurance, or public utilities.

**Table of Contents**

|                                                 | For the Three Months Ended |                      | For the Six Months Ended |                      |
|-------------------------------------------------|----------------------------|----------------------|--------------------------|----------------------|
|                                                 | June 30,                   |                      | June 30,                 |                      |
|                                                 | 2005                       | 2004                 | 2005                     | 2004                 |
| Revenue                                         |                            |                      |                          |                      |
| SBA lending                                     | \$ 3,712,269               | \$ 3,158,625         | \$ 5,934,660             | \$ 5,298,678         |
| Electronic payment processing                   | 8,544,953                  | 4,070,630            | 14,555,936               | 7,303,134            |
| Web hosting                                     | 2,673,614                  |                      | 4,922,490                |                      |
| Capco and other                                 | 11,295,038                 | 7,253,080            | 14,124,272               | 9,751,016            |
| <b>Total</b>                                    | <b>\$ 26,225,874</b>       | <b>\$ 14,482,335</b> | <b>\$ 39,537,358</b>     | <b>\$ 22,352,828</b> |
| Income (loss) before provision for income taxes |                            |                      |                          |                      |
| SBA lending                                     | \$ 1,137,998               | \$ 1,431,185         | \$ 482,265               | \$ 1,719,946         |
| Electronic payment processing                   | 1,149,945                  | 95,066               | 1,103,945                | 105,639              |
| Web hosting                                     | 918,399                    |                      | 1,861,398                |                      |
| Capco and other                                 | 3,795,235                  | 1,580,675            | (1,309,774)              | (1,606,890)          |
| <b>Total</b>                                    | <b>\$ 7,001,577</b>        | <b>\$ 3,106,926</b>  | <b>\$ 2,137,834</b>      | <b>\$ 218,695</b>    |
| Depreciation and amortization                   |                            |                      |                          |                      |
| SBA lending                                     | \$ 347,233                 | \$ 112,183           | \$ 745,297               | \$ 191,387           |
| Electronic payment Processing                   | 225,029                    | 172,065              | 411,778                  | 340,669              |
| Web hosting                                     | 488,720                    |                      | 845,945                  |                      |
| Capco and other                                 | 122,918                    | 43,023               | 270,275                  | 85,536               |
| <b>Total</b>                                    | <b>\$ 1,183,900</b>        | <b>\$ 327,271</b>    | <b>\$ 2,273,295</b>      | <b>\$ 617,592</b>    |
| Intercompany revenue eliminated above           |                            |                      |                          |                      |
| SBA lending                                     | \$                         | \$                   | \$                       | \$                   |
| Electronic payment Processing                   | 410,139                    | 236,365              | 746,404                  | 451,297              |
| Web hosting                                     | 52,835                     |                      | 53,075                   |                      |
| Capco and other                                 | 1,341,026                  | 488,692              | 2,436,855                | 905,224              |
| <b>Total</b>                                    | <b>\$ 1,804,000</b>        | <b>\$ 725,057</b>    | <b>\$ 3,236,334</b>      | <b>\$ 1,356,521</b>  |
| Intercompany expenses eliminated above          |                            |                      |                          |                      |
| SBA lending                                     | \$ 540,499                 | \$ 161,783           | \$ 963,303               | \$ 319,896           |
| Electronic payment Processing                   | 677,605                    | 337,882              | 1,249,235                | 658,538              |
| Web hosting                                     | 63,928                     |                      | 133,027                  |                      |
| Capco and other                                 | 521,968                    | 225,392              | 890,769                  | 378,087              |
| <b>Total</b>                                    | <b>\$ 1,804,000</b>        | <b>\$ 725,057</b>    | <b>\$ 3,236,334</b>      | <b>\$ 1,356,521</b>  |
| Identifiable Assets                             |                            |                      |                          |                      |
| SBA lending                                     |                            |                      | \$ 53,308,403            | \$ 48,839,937        |

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|                               |                       |                       |
|-------------------------------|-----------------------|-----------------------|
| Electronic payment processing | 6,815,526             | 3,507,162             |
| Web hosting                   | 14,791,018            | 12,367,893            |
| Capco & other                 | 174,248,197           | 163,682,924           |
|                               | <hr/>                 | <hr/>                 |
| <b>Total</b>                  | <b>\$ 249,163,144</b> | <b>\$ 228,397,916</b> |
|                               | <hr/>                 | <hr/>                 |

**Table of Contents**

**NOTE 11 SUBSEQUENT EVENT:**

In July 2005, NSBF signed a commitment letter to enter into a 3 year agreement with GE Capital Corporation for a \$75 million senior secured revolving line of credit. This line is pending SBA approval and will replace the current bank notes payable with Deutsche Bank.

In August 2005, the Company was notified that there was an additional allocation of Capco funds for Wilshire Texas Partners LLC, and received cash of approximately \$634,000.

In August 2005, the Company paid the CEO of CrystalTech \$750,000 and issued 208,333 common shares valued at \$750,000 in connection with the purchase agreement upon CrystalTech achieving certain financial benchmarks.

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**Table of Contents**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION:**

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

*The statements in this Quarterly Report may contain forward-looking statements relating to such matters as anticipated future financial performance, business prospects, legislative developments and similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, we note that a variety of factors could cause our actual results to differ materially from the anticipated results expressed in the forward looking statements such as intensified competition and/or operating problems on its operating business projects and their impact on revenues and profit margins or additional factors as described in Newtek Business Services' previously filed registration statements.*

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

**Critical Accounting Policies and Estimates:**

The Company's significant accounting policies are described in note 1 of the Notes to Consolidated Financial Statements included in its Form 10-K for the fiscal year ended December 31, 2004. A discussion of the Company's critical accounting policies, and the related estimates, are included in Management's Discussion and Analysis of Results of Operations and Financial Position in its Form 10-K for the fiscal year ended December 31, 2004. There have been no significant changes in the Company's existing accounting policies or estimates since its fiscal year ended December 31, 2004.

**Comparison of the six months ended June 30, 2005 and June 30, 2004**

Total revenues increased by approximately \$17,184,000 to \$39,537,000 for the six months ended June 30, 2005, from \$22,353,000 for the six months ended June 30, 2004. Income from tax credits increased by approximately \$2,349,000 from \$9,048,000 for the six months ended June 30, 2004, to \$11,397,000 for the six months ended June 30, 2005, due to Newtek's capco, Wilshire DC Partners achieving the 50% hurdle in the six months ended June 30, 2005 and recognizing approximately \$9,200,000 compared to the hurdles hit in the same period in the prior year for Wilshire Louisiana III, IV and Wilshire Colorado totaling \$7,400,000. In addition, there was 3 additional capcos recording income from accretion of tax credits in the six months ended June 30, 2005.

Electronic payment processing revenue increased by approximately \$6,217,000 to \$13,520,000 for the six months ended June 30, 2005, from \$7,303,000 for the six months ended June 30, 2004, due to the Company's increase in electronic payment processing customers, as well as an additional qualified business formed in Alabama in August 2004. At June 30, 2005, we provided our payment services to approximately 11,000 small merchants across the United States, compared to approximately 5,600 customers at June 30, 2004. Gross total processing volume increased to approximately \$648,709,000 from all merchant portfolios (of this amount, approximately \$152,584,000 of processing volume

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generated revenues that were recorded net of interchange fees) for the six months ended June 30, 2005 from \$413,059,000 of gross processing volume (of this amount, approximately \$171,722,000 of processing volume generated revenues that were recorded net of interchange fees) for the six months ended June 30, 2004.

**Table of Contents**

Servicing fee and premium income increased by approximately \$202,000 to \$3,456,000 for the six months ended June 30, 2005 from approximately \$3,254,000 for the six months ended June 30, 2004. The increase in servicing fee income of approximately \$150,000 was attributable to the servicing portfolio's growth year over year. The servicing portfolio at June 30, 2005 aggregated approximately \$174,420,000 as compared with approximately \$146,271,000 at June 30, 2004. The increase in premium income of \$52,000 was attributable to NSBF selling 84 guaranteed loans in the six months ended June 30, 2005, aggregating approximately \$22,939,000 as compared to 68 loans sold aggregating \$17,423,000 in the same period for the prior year. The premiums recognized in connection with these sales were approximately \$1,931,000 during the six months ended June 30, 2005 as compared with approximately \$1,503,000 in the same period for the prior year.

In addition, in June 2005, NSBF sold to two financial institutions approximately \$6,064,000 of loans previously classified as held for investment for aggregate proceeds of approximately \$6,314,000. This represented a portion of the unguaranteed piece of 95 loans. The carrying value above the \$6,064,000 of loans previously classified as held for investment of \$250,000 was recorded as premium income. Also, in connection with this sale, included in premium income for the six months ended June 30, 2005 is approximately \$337,000 representing the allocated portion of the remaining discount recorded at the time of loan origination. In June 2004, NSBF sold to a bank approximately \$17,022,000 of loans previously classified as held for investment for aggregate proceeds of approximately \$17,661,000. This represented a portion of the unguaranteed piece of 180 loans. The carrying value above the \$17,022,000 of loans previously classified as held for investment of \$639,000 was recorded as premium income. Also, in connection with this sale, included in premium income for the six months ended June 30, 2004 is approximately \$324,000 representing the allocated portion of the remaining discount recorded at the time of loan origination.

Interest and dividends are generated from SBA lending activities, excess cash balances that are invested in low risk, highly liquid securities (money market accounts, federal government backed mutual funds, etc.) non-cash accretions of structured insurance product and on held to maturity investments. The following table details the changes in these different forms of interest and dividend income for the six month periods ended June 30:

|                                   | 2005                | 2004                | Change            |
|-----------------------------------|---------------------|---------------------|-------------------|
| SBA lending activities            | \$ 1,791,104        | \$ 1,845,749        | \$ (54,645)       |
| Non-cash accretions               | 87,808              | 87,808              |                   |
| Qualified investments             | 67,152              | 49,428              | 17,724            |
| Low-risk highly liquid securities | 383,261             | 88,178              | 295,083           |
|                                   | <u>\$ 2,329,325</u> | <u>\$ 2,071,163</u> | <u>\$ 258,162</u> |

The approximate \$295,000 increase in interest income generated from low-risk highly liquid securities is attributable to an increase in the average outstanding balances and interest rates on interest bearing cash accounts.

Web hosting and insurance commissions for the six months ended June 30, 2005 increased to approximately \$4,911,000 and \$717,000, respectively, from \$0 and \$0, respectively due to the acquisitions of CrystalTech and Newtek Insurance Agency (formerly known as Vistar Insurance Agency) in the third quarter of 2004, and the formation of National Insurance Solutions, LLC in June 2004.

**Table of Contents**

Other income increased by approximately \$2,530,000 to \$3,206,000 for the six months ended June 30, 2005 from \$676,000 for the six months ended June 30, 2004. Included in other income for the six months ended June 30, 2005 is a \$900,000 recovery of an investment in Merchant Data Systems received from a legal settlement, \$749,000 of equity earnings from Exponential Business Development, L.P., as well as approximately \$475,000 of other income from the settlement of loan recovery costs from the Small Business Administration.

Changes in interest expense are summarized as follows for the six months periods ended June 30:

|                                    | 2005                | 2004                | Change            |
|------------------------------------|---------------------|---------------------|-------------------|
| Capco interest expense             | \$ 6,066,878        | \$ 5,884,294        | \$ 182,584        |
| NSBF (SBA Lender) interest expense | 987,271             | 1,000,117           | (12,846)          |
| Other interest                     | 523,457             | 358,386             | 165,071           |
|                                    | <u>\$ 7,577,606</u> | <u>\$ 7,242,797</u> | <u>\$ 334,809</u> |

The approximately \$183,000 net increase in Capco interest expense in the six months ended June 30, 2005 was attributable to the approximate \$488,000 accretion of interest expense by the three additional Capcos in the current period versus the same period in 2004, offset by earlier Capcos having less interest expense under the effective interest method. The approximately \$165,000 net increase in other interest expense was attributable to approximately \$249,000 of interest on the TICC note that CrystalTech financed on March 28, 2005, offset by a decrease in interest expense on insurance coverage that has been paid after June 30, 2004.

Payroll and consulting fees increased by approximately \$3,765,000 to \$8,311,000 for the six months ended June 30, 2005 from \$4,546,000 for the six months ended June 30, 2004. The increase was primarily due to the significant growth in the merchant processing segment and the eleven additional operating entities consolidated into Newtek in the six months ended June 30, 2005 versus the same period in 2004. In particular, CrystalTech and Newtek Insurance Agency's payroll and consulting fees approximated \$1,361,000 for the six months ended June 30, 2005 compared to \$0 in the prior period. Electronic payment processing direct costs increased by approximately \$4,819,000 to \$9,951,000 for the six months ended June 30, 2005 from \$5,132,000 for the six months ended June 30, 2004, due to the significant increase in the volume of processed transactions due to an increase in the number of electronic payment processing customers as well as an increase in interchange fees.

Professional fees increased by approximately \$1,702,000 to \$3,539,000 for the six months ended June 30, 2005 from \$1,837,000 for the six months ended June 30, 2004. This increase is primarily due to the increased legal and accounting services provided due to the significant growth in the company in the six months ended June 30, 2005 as compared to the six months ended June 30, 2004. Total professional fees incurred by CrystalTech and Newtek Insurance Agency were approximately \$719,000 for the six months ended June 30, 2005 compared to \$0 for the prior comparative period. Insurance expense increased by approximately \$57,000 to \$1,463,000 for the six months ended June 30, 2005 from \$1,406,000 for the six months ended June 30, 2004. This increase is due to the additional insurance relating to the new Capcos funded in the third and fourth quarter of 2004, Wilshire DC Partners and Wilshire New York Partners IV, as well as the new Capco funded in the six months ended June 30, 2005, Wilshire Texas Partners.

Provision for loan losses increased to approximately \$1,101,000 for the six months ended June 30, 2005 from a benefit, or recovery of approximately \$47,000 for the six months ended June 30, 2004. This \$1,148,000 increase is attributable to NSBF booking approximately \$800,000 in additional reserves associated with the Commercial Capital Corporation (CCC) portfolio which was acquired on December



## **Table of Contents**

31, 2002. Due to charge offs of certain CCC loans in the second quarter of 2005, the allowance for loan loss reserve was depleted to a level that management determined would require additional reserves to cover the remaining CCC portfolio balance. The remaining increase of \$300,000 is attributable to general reserves being recorded on newly originated loans. Additionally, in June 2004, NSBF sold loans to a bank previously classified as held for investment. In connection with this sale, NSBF reversed the reserve for loan losses associated with these loans and recorded a benefit of approximately \$288,000, offset by \$241,000 in loan loss provisions.

Depreciation and amortization increased by approximately \$1,655,000 to \$2,273,000 for the six months ended June 30, 2005 from \$618,000 for the six months ended June 30, 2004. Of this increase, approximately \$993,000 is due to the depreciation and amortization of fixed assets, customer accounts and intangibles for CrystalTech and Newtek Insurance Agency. In addition, NSBF's amortization of the servicing assets and deferred financing costs increased by approximately \$522,000 due to the servicing assets growth year over year from June 30, 2005 compared to June 30, 2004 and the amortization of costs associated with the July 1, 2004 Deutsche Bank amendment to NSBF's existing credit agreement.

Other expenses increased by approximately \$1,545,000 to \$3,554,000 for the six months ended June 30, 2005 from \$2,009,000 for the six months ended June 30, 2004. Specifically, the operations of CrystalTech and Newtek Insurance Agency contributed approximately \$1,134,000 in other expenses for the six month period ended June 30, 2005 compared to \$0 for the same period in the prior year.

The change in the effective tax rate is due to the inability of the company to utilize NSBF's loss to reduce its provision. This is due to the fact that NSBF is not included in the consolidated group for tax reporting purposes; therefore its losses cannot be used to offset taxable income of the consolidated group.

The Company's net income increased by approximately \$959,000 from \$129,000 for the six months ended June 30, 2004 to \$1,088,000 for the six months ended June 30, 2005, due to the increase in total revenues of approximately \$17,185,000, offset by the increases in overall expenses of approximately \$15,027,000 discussed above, the increase in taxes of approximately \$960,000, and the decrease in minority interest of approximately \$239,000.

### **Comparison of the three months ended June 30, 2005 and June 30, 2004**

Revenues increased by approximately \$11,744,000 to \$26,226,000 for the three months ended June 30, 2005, from \$14,482,000 for the three months ended June 30, 2004. Income from tax credits increased by approximately \$3,311,000 from \$7,025,000 for the three months ended June 30, 2004, to \$10,336,000 for the three months ended June 30, 2005, due to additional income recognized in achieving investment thresholds in the DC capco in the three months ended June 30, 2005, compared to the Louisiana III capco program in the three months ended June 30, 2004. Electronic payment processing revenue increased by approximately \$3,438,000 to \$7,509,000 for the three months ended June 30, 2005, from \$4,071,000 for the three months ended June 30, 2004, due to the Company's increase in electronic payment processing customers, and an additional qualified business formed in Alabama in August 2004. At June 30, 2005, we provided our payment services to approximately 11,000 small merchants across the United States, compared to approximately 5,600 customers at June 30, 2004. Gross total processing volume increased to approximately \$346,569,000 from all merchant portfolios (of this amount, approximately \$75,285,000 of processing volume generated revenues that were recorded net of interchange fees) for the three months ended June 30, 2005 from \$215,488,000 of gross processing volume (of this amount, approximately \$80,890,000 of processing volume generated revenues that were recorded net of interchange fees) for the three months ended June 30, 2004.

Servicing fee and premium income increased by approximately \$501,000 to \$2,643,000 for the three months ended June 30, 2005 from approximately \$2,142,000 for the three months ended June 30, 2004. The increase in servicing fee income of approximately \$71,000 was

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attributable to the servicing portfolio's growth year over year. The servicing portfolio at June 30, 2005 aggregated approximately \$174,420,000 as compared with approximately \$146,271,000 at June 30, 2004. We sold 49 guaranteed

**Table of Contents**

loans in the three months ended June 30, 2005, aggregating approximately \$17,282,000 as compared to 39 loans aggregating approximately \$7,974,000 in the same period for the prior year. The premiums recognized in connection with these sales were approximately \$1,569,000 during the three months ended June 30, 2005 as compared with approximately \$698,000 in the same period for the prior year.

In addition, in June 2005, NSBF sold to two financial institutions approximately \$6,064,000 of loans previously classified as held for investment for aggregate proceeds of approximately \$6,314,000. This represented a portion of the unguaranteed piece of 95 loans. The carrying value above the \$6,064,000 of loans previously classified as held for investment of \$250,000 was recorded as premium income. Also, in connection with this sale, included in premium income for the six months ended June 30, 2005 is approximately \$337,000 representing the allocated portion of the remaining discount recorded at the time of loan origination. In June 2004, NSBF sold to a bank approximately \$17,022,000 of loans previously classified as held for investment for aggregate proceeds of approximately \$17,661,000. This represented a portion of the unguaranteed piece of 180 loans. The carrying value above the \$17,022,000 of loans previously classified as held for investment of \$639,000 was recorded as premium income. Also, in connection with this sale, included in premium income is approximately \$324,000 representing the allocated portion of the remaining discount recorded at the time of loan origination.

Web hosting and insurance commissions for the three months ended June 30, 2005 increased to approximately \$2,662,000 and \$497,000, respectively, from \$0 and \$0, respectively due to the acquisitions of CrystalTech and Newtek Insurance Agency (formerly known as Vistar Insurance Agency) in the third quarter of 2004 and the formation of National Insurance Solutions, LLC in June, 2004.

Interest and dividends are generated from SBA lending activities, excess cash balances that are invested in low risk, highly liquid securities (money market accounts, federal government backed mutual funds, etc.), non-cash accretions of structured insurance product and on held to maturity investments. The following table details the changes in these different forms of interest and dividend income:

|                                   | 2005                | 2004                | Change            |
|-----------------------------------|---------------------|---------------------|-------------------|
| SBA lending activities            | \$ 953,345          | \$ 920,746          | \$ 32,599         |
| Non-cash accretions               | 47,456              | 43,904              | 3,552             |
| Qualified investments             | 56,847              | 28,599              | 28,248            |
| Low-risk highly liquid securities | 198,544             | 48,966              | 149,578           |
|                                   | <u>\$ 1,256,192</u> | <u>\$ 1,042,215</u> | <u>\$ 213,977</u> |

The approximate \$150,000 increase in interest income generated from low-risk highly liquid securities is attributable to an increase in the average outstanding balances and interest rates on interest bearing cash accounts.

Other income increased by approximately \$1,120,000 to \$1,323,000 for the three months ended June 30, 2005 from \$203,000 for the three months ended June 30, 2004. This increase is primarily due to a \$900,000 recovery of an investment in Merchant Data Systems received from a legal settlement.

**Table of Contents**

Changes in interest expense are summarized as follows:

|                                    | 2005                | 2004                | Change            |
|------------------------------------|---------------------|---------------------|-------------------|
| Capco interest expense             | \$ 3,032,830        | \$ 2,862,878        | \$ 169,952        |
| NSBF (SBA Lender) interest expense | 535,434             | 498,244             | 37,190            |
| Other interest                     | 312,051             | 116,900             | 195,151           |
|                                    | <u>\$ 3,880,315</u> | <u>\$ 3,478,022</u> | <u>\$ 402,293</u> |

The approximately \$170,000 net increase in Capco interest expense in the three months ended June 30, 2005 was attributable to the approximate \$305,000 of expense incurred by the three additional Capcos in the current period, offset by earlier Capcos having less interest expense under the effective interest method. The approximately \$195,000 net increase in other interest expense was attributable to approximately \$249,000 of interest on the TICC note that CrystalTech financed on March 28, 2005, offset by a decrease in interest expense on insurance coverage that has been paid after June 30, 2004.

Payroll and consulting fees increased by approximately \$1,854,000 to \$4,215,000 for the three months ended June 30, 2005 from \$2,361,000 for the three months ended June 30, 2004. The increase was primarily due to the increased number of operating entities consolidated into Newtek in the three months ended June 30, 2005 versus the same period in 2004. Specifically, salaries and benefits for the acquired companies CrystalTech and Newtek Insurance Agency incurred approximately \$575,000 of payroll and consulting fees in the three months ended June 30, 2005 compared to \$0 for the prior comparative period. Electronic payment processing costs increased by approximately \$2,438,000 to \$5,470,000 for the three months ended June 30, 2005 from \$3,032,000 for the three months ended June 30, 2004, due to the significant increase in the volume of processed transactions due to an increase in the number of electronic payment processing customers as well as an increase in interchange fees.

Professional fees increased by approximately \$958,000 to \$1,801,000 for the three months ended June 30, 2005 from \$843,000 for the three months ended June 30, 2004. This increase is primarily due to the increased legal and accounting services provided due to the significant growth in the company in the three months ended June 30, 2005 as compared to the three months ended June 30, 2004. Total professional fees incurred by CrystalTech and Newtek Insurance Agency was approximately \$500,000 for the three months ended June 30, 2005 compared to \$0 for the prior comparative period. Insurance expense increased by approximately \$52,000 to \$743,000 for the three months ended June 30, 2005 from \$691,000 for the three months ended June 30, 2004.

Provision for loan losses increased to approximately \$450,000 for the three months ended June 30, 2005 from a benefit, or recovery of approximately \$152,000 for the three months ended June 30, 2004. This \$602,000 increase is attributable to NSBF booking approximately \$229,000 in additional reserves associated with the acquired Commercial Capital Corporation (CCC) portfolio at December 31, 2002. Due to charge offs of certain CCC loans in the second quarter of 2005, the allowance for loan loss reserve was depleted to a level that management determined would require additional reserves to cover the remaining CCC portfolio balance. The remaining increase of \$373,000 is attributable to \$221,000 of general reserves being recorded on newly originated loans and NSBF selling loans to a bank in June 2004 that were previously classified as held for investment. In connection with this sale, NSBF reversed the reserve for loan losses associated with these loans and recorded a benefit of approximately \$288,000, offset by \$136,000 in loan loss provisions.

Depreciation and amortization increased by approximately \$857,000 to \$1,184,000 for the three months ended June 30, 2005 from \$327,000 for the three months ended June 30, 2004. Of this increase, approximately \$536,000 is due to the depreciation and amortization of fixed assets, customer accounts and intangibles for CrystalTech and Newtek Insurance Agency. In addition, the amortization of servicing assets and deferred

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financing costs increased approximately \$206,000 due to the servicing assets growth year over year from June 30, 2004 compared to June 30, 2005 and the amortization of costs associated with the July 1, 2004 Deutsche Bank amendment to NSBF's existing credit agreement.

## **Table of Contents**

Other expenses increased by approximately \$488,000 to \$1,594,000 for the three months ended June 30, 2005 from \$1,106,000 for the three months ended June 30, 2004. Specifically, the operations of CrystalTech and Newtek Insurance Agency contributed approximately \$544,000 in other expenses for the three month period ended June 30, 2005 compared to \$0 for the same period in the prior year. This was offset by a concentrated effort to reduce operating expenses in the consolidating entities other than CrystalTech and Newtek Insurance Agency, described above.

The change in the effective tax rate is due to the inability of the company to utilize NSBF's loss to reduce its provision. This is due to the fact that NSBF is not included in the consolidated group for tax reporting purposes; therefore its losses cannot be used to offset taxable income of the consolidated group.

The Company's net income increased by approximately \$2,810,000 from \$1,833,000 for the three months ended June 30, 2004 to \$4,463,000 for the three months ended June 30, 2005, due to the increase in overall revenues of approximately \$11,744,000 discussed above, offset by increases in expenses of approximately \$7,650,000, an increase in the provision for income taxes of approximately \$1,265,000 and a decrease in minority interest of approximately \$198,000.

## **Liquidity and Capital Resources**

Newtek has funded its operations primarily through the issuance of notes to insurance companies through the Capco programs. Through June 30, 2005, Newtek has received approximately \$226,626,000 in proceeds from the issuance of long-term debt, Capco warrants, and Newtek common shares through the Capco programs. In 2004, Newtek raised approximately \$20,762,000 (net of related offering costs) in a secondary public offering. Newtek's principal capital requirements have been to fund the purchase of Coverage A insurance related to the notes issued to the insurance companies (approximately \$119,898,000), the acquisition of Coverage B Capco insurance policies (\$26,841,000), the acquisitions of CrystalTech and Newtek Insurance Agency (\$9,836,000) and the acquisition of consolidated operating entities' interests, identifying other Capco-qualified investments, and working capital needs resulting from operating and business development activities of its consolidated operating entities.

Net cash used in operating activities for the six months ended June 30, 2005 of approximately \$13,826,000 resulted primarily from net income of \$1,088,000 adjusted for the non-cash interest expense of approximately \$6,067,000, proceeds from sale of SBA loans held for sale of approximately \$22,939,000, and other non cash charges for stock compensation, depreciation and amortization, and provision for loan losses totaling approximately \$4,245,000. It was also affected by the approximately \$913,000 of a deferred tax benefit, approximately \$372,000 of minority interest, approximately \$11,397,000 in non-cash income from tax credits, approximately \$749,000 of equity earnings in investee and approximately \$24,300,000 in SBA loans originated for sale. In addition, Newtek had a net decrease in components of prepaid insurance, prepaid expenses, accounts receivable and other assets, and accounts payable and accruals of approximately \$11,769,000.

Net cash used in operating activities for the six months ended June 30, 2004 of approximately \$5,169,000 resulted primarily from net income of \$129,000 adjusted for the non-cash interest expense of approximately \$5,884,000, proceeds from the sale of SBA loans of approximately \$17,423,000, and other non cash charges for stock compensation, depreciation and amortization totaling approximately \$1,368,000. It was also affected by the approximately \$90,000 of a deferred tax provision, offset by approximately \$610,000 of minority interest, approximately \$9,048,000 in non-cash income from tax credits, \$638,000 of a gain on sale of loans held for investment, and approximately \$16,644,000 in SBA loans originated for sale. In addition, Newtek had a net decrease in components of prepaid insurance, prepaid expenses and other assets, accounts receivable and servicing assets, and accounts payable and accruals of approximately \$2,963,000.



## **Table of Contents**

Net cash used in investing activities for the six months ended June 30, 2005 of approximately \$1,080,000 resulted primarily from approximately \$7,893,000 of SBA loans originated for investment, \$1,439,000 of purchase of furniture, fixtures and equipment, \$877,000 of purchases of customer merchant accounts and \$2,591,000 of investments in qualified businesses, offset by proceeds from sale of SBA loans held for investment of approximately \$6,313,000, repayments on SBA loans of approximately \$3,116,000, distributions from an investee of \$820,000 and returns of investments of approximately \$1,501,000.

Net cash provided by investing activities for the six months ended June 30, 2004 of approximately \$14,297,000 resulted primarily from \$17,661,000 of proceeds from sale of SBA loans held for investment, \$4,258,000 from repayment of SBA loans, and \$2,506,000 from returns of principal from qualified investments. This was offset by investments in qualified businesses totaling \$6,016,000, SBA loans originated for investment of approximately \$7,279,000, other investments of \$215,000 and approximately \$291,000 of purchases of furniture, fixtures and equipment.

Net cash provided by financing activities for the six months ended June 30, 2005 was approximately \$23,568,000, primarily attributable to proceeds from the issuance of long term debt of approximately \$22,824,000, proceeds from issuance of note payable other of approximately \$8,014,000, proceeds from issuance of common stock of \$713,000 and approximately \$1,792,000 in proceeds from SBA bank notes. This was offset by approximately \$6,008,000 in purchase of Coverage A, \$1,692,000 in payments on notes payable-insurance, repurchase of \$1,500,000 of mandatorily redeemable preferred stock, \$520,000 in payments of notes payable-other, and a change in restricted cash of approximately \$56,000.

Net cash used in financing activities for the six months ended June 30, 2004 was approximately \$4,923,000, primarily attributable to proceeds from the issuance of long term debt of approximately \$10,896,000, approximately \$1,968,000 from the private placement of common stock and exercise of stock options and a change in restricted cash of approximately \$47,000. This was offset by approximately \$2,150,000 in payments for insurance, \$1,112,000 in payments on notes payable-insurance, \$240,000 in payments of notes payable-other and repayments on SBA bank notes payable of \$14,332,000.

During the six months ended June 30, 2005 we and our affiliated companies generated cash flow primarily from the following sources:

proceeds from issuance of long-term debt and common stock of \$23,537,000;

interest and dividend income of approximately \$2,329,000;

proceeds from sales of SBA loans held for sale and loans held for investment, reclassified as held for sale of approximately \$29,252,000;

other income of approximately \$3,206,000, which represents revenue from Newtek's consolidated operating entities;

repayments from qualified investments of approximately \$1,501,000

proceeds from note payable-other of approximately \$8,014,000;

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cash received from repayments of SBA loans receivable of approximately \$3,114,000; and

proceeds from SBA bank notes payable of approximately \$1,792,000.

The cash was primarily used to:

originate approximately \$32,193,000 in SBA loans originated for sale and held for investment:

purchase Coverage A insurance of approximately \$6,008,000;

repurchase mandatorily redeemable preferred stock of \$1,500,000;

invest in Qualified Businesses of approximately \$2,591,000;

repay note payable-insurance of approximately \$1,692,000;

repay notes payable other of approximately \$520,000;

purchase customer merchant accounts of approximately \$877,000; and

purchase furniture, fixtures and equipment of approximately \$1,893,000.

## **Table of Contents**

During the six months ended June 30, 2004 we and our affiliated companies generated cash flow primarily from the following sources:

private placement of common shares and exercise of stock options, netting \$1,968,000;

proceeds from issuance of a long-term debt and warrants of \$10,896,000;

interest and dividend income of approximately \$2,071,000;

other income of approximately \$676,000, which represents revenue from Newtek's consolidated operating entities;

proceeds from sales of SBA loans of approximately \$17,423,000;

payments received on SBA loans of approximately \$4,258,000; and

proceeds from sale of SBA loans held for investment, reclassified as held for sale of approximately \$17,661,000.

The cash was primarily used to:

originate approximately \$23,923,000 in SBA loans held for investment and for sale;

invest in Qualified Businesses of approximately \$6,016,000;

repay SBA bank notes payable of approximately \$14,332,000;

repay note payable-insurance of approximately \$1,112,000; and

purchase of Coverage A insurance of approximately \$2,150,000.

## **FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q contains forward-looking statements. Additional written or oral forward-looking statements may be made by Newtek from time to time in filings with the Securities and Exchange Commission or otherwise. The words "believe," "expect," "seek," and "intend" and similar expressions identify forward-looking statements, which speak only as of the date the statement is made. Such forward-looking statements are within the meaning of that term in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements may include, but are not limited to, projections of income or loss, expenditures,

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acquisitions, plans for future operations, financing needs or plans relating to our services, as well as assumptions relating to the foregoing. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. Future events and actual results could differ materially from those set forth in, contemplated by or underlying the forward-looking statements.

We do not undertake, and specifically disclaim, any obligation to publicly release the results of revisions which may be made to forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after such statements.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK:**

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

We transact business with merchants exclusively in the United States and receive payment for our services exclusively in United States dollars. As a result, our financial results are unlikely to be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets.

## **Table of Contents**

Our interest expense is sensitive to changes in the general level of interest rates in the United States, because a majority of our indebtedness is at variable rates. At June 30, 2005, \$29.8 million of our outstanding indebtedness was at variable interest rates based on the prime rate. A rise in the prime rate of one percentage point would result in additional interest expense of approximately \$298,000. However, our interest income would also increase by approximately the same amount, due to the variability of the interest rates on our SBA loans receivable. Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet, and other business developments that could affect net increase (decrease) in assets. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate.

We do not hold derivative financial or commodity instruments, nor engage in any foreign currency denominated transactions, and all of our cash and cash equivalents are held in money market and checking funds.

## **ITEM 4. CONTROLS AND PROCEDURES**

Newtek Business Services, Inc., or Newtek, conducted an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14 as in place on June 30, 2005 and during the three month period then ending. Based upon that evaluation, our Chief Executive Officer in consultation with the Audit Committee of the Board of Directors concluded that, with one exception, our disclosure controls and procedures were effective to ensure that material information relating to Newtek (including its consolidated subsidiaries) required to be included in our periodic SEC filings is recorded, processed, summarized and reported within the required time period.

The one exception was a loan made by Newtek Small Business Finance, Inc., or NSBF, was determined to be impaired which resulted in an adjustment to the allowance for loan losses for the quarter ended March 31, 2005. This matter first arose prior to March 31, 2005 but only after the subsequent events in April was it determined to be a loss. The failure to bring this matter to the attention of the appropriate parties within Newtek and correctly reflect the loss in the financial statements for the period ended March 31, 2005, resulted in the restatement of the financial statements of Newtek for that period. In light of that restatement, Newtek management and the Audit Committee of its Board of Directors have determined that the internal controls and procedures regarding disclosure constitutes a material weakness as of March 31, 2005 and June 30, 2005. This determination was made on August 16, 2005 and on August 17, 2005 changes to NSBF's applicable policy were made in an attempt to prevent a reoccurrence of such an event. In particular, the following enhancements were implemented:

NSBF's Risk Management Committee was increased by the addition of NSBF's Controller and Newtek's Chief Financial Officer as permanent members;

meetings of the Risk Management Committee have been scheduled to occur each month and as needed, rather than each quarter and as needed; and

the Vice President of Asset Management of NSBF will now immediately notify NSBF's Controller and Newtek's Controller and CFO in writing of suggested charge-offs or specific allowances of \$100,000 or more.

The above referenced evaluation led to the conclusion that the financial statements required restatement, a cautionary statement to the public that the previous March 31, 2005 financial statements should no longer be relied upon. Newtek believes that the addition of the procedures specified above should eliminate the possibility of such subsequent events not being considered as such in the preparation of our consolidated financial statements and fully address and rectify the weakness identified.

There was no change in our internal controls over financial reporting during the most recent fiscal quarter covered by this quarterly report that materially affected, or is reasonably likely to affect materially, Newtek's internal controls over financial reporting. However, subsequent to June 30, 2005 and contemporaneously with the filing of this Form 10-Q, Newtek has implemented changes to its internal controls, as described above, to correct the material weakness identified above. Newtek will continue to evaluate the effectiveness of its internal controls and procedures on an ongoing basis and will take further action as appropriate.

## **PART II - OTHER INFORMATION**

### **ITEM 2. UNREGISTERED SALE OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following non-registered transaction in the securities of Newtek Business Services, Inc. occurred in the three month period ending June 30, 2005. All securities sold were Newtek's common shares and all sales were to accredited investors and in reliance on Section 4(2) of the Securities Act of 1933, as amended, and applicable New York State law. All sales were made at a price of 90% of the average of the high and low trading prices of our common shares on the date of the sale.

**Table of Contents**

(c)

| <u>Purchaser</u>                                               | <u>Common<br/>Shares</u> | <u>Price and Date</u> |
|----------------------------------------------------------------|--------------------------|-----------------------|
| American International Specialty Lines Insurance Company, Inc. | 122,493                  | \$ 2.16 June 20, 2005 |
| Hare & Co                                                      | 58,000                   | \$ 2.16 June 20, 2005 |
| Federal Insurance Company                                      | 30,000                   | \$ 2.16 June 20, 2005 |
| Principal Life Insurance Co.                                   | 30,000                   | \$ 2.16 June 20, 2005 |
| Pacific Life Insurance Co.                                     | 30,000                   | \$ 2.16 June 20, 2005 |
| Massachusetts Mutual Life Insurance Co.                        | 24,000                   | \$ 2.16 June 20, 2005 |
| Transamerica Occidental Life Insurance Co.                     | 15,000                   | \$ 2.16 June 20, 2005 |
| Stonebridge Life Insurance Co.                                 | 7,000                    | \$ 2.16 June 20, 2005 |
| Conseco Life Insurance Co.                                     | 6,000                    | \$ 2.16 June 20, 2005 |
| C.M. Life Insurance                                            | 6,000                    | \$ 2.16 June 20, 2005 |

**ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

(a) On May 24, 2005 we held our annual meeting of shareholders, at which there were present in person or by proxy 30,934,178, or 90.15%, of the outstanding common shares.

(b) All seven of the incumbent directors were reelected for one year terms with votes as follows:

|                          | <u>FOR</u> | <u>WITHHELD</u> |
|--------------------------|------------|-----------------|
| David C. Beck            |            |                 |
| (One-year term)          | 30,665,954 | 268,224         |
| Christopher G. Payan     |            |                 |
| (One-year term)          | 30,665,954 | 268,254         |
| Jeffrey G. Rubin         |            |                 |
| (One-year term)          | 30,662,162 | 272,016         |
| Steven A. Shenfeld       |            |                 |
| (One-year term)          | 30,662,254 | 271,924         |
| Jeffrey M. Schottenstein |            |                 |
| (One-year term)          | 30,665,862 | 268,824         |
| Barry Sloane             |            |                 |
| (One-year term)          | 30,662,862 | 271,316         |

Brian A. Wasserman

|                 |            |         |
|-----------------|------------|---------|
| (One-year term) | 30,547,038 | 387,140 |
|-----------------|------------|---------|

## **Table of Contents**

(c) In addition to the election of directors, shareholders voted upon and approved an increase in the number of authorized common shares of the Company to 54,000,000. The vote was:

|            |                  |
|------------|------------------|
| For:       | 30,394,164 votes |
| Withheld:  | 552,912 votes    |
| Abstained: | 17,102 votes     |

(d) The shareholders also voted for and approved the ratification of the selection of PricewaterhouseCoopers LLP as auditors for the Company for the year ending December 31, 2005. The vote was:

|            |                  |
|------------|------------------|
| For:       | 30,612,752 votes |
| Withheld:  | 32,680 votes     |
| Abstained: | 288,566 votes    |

## **ITEM 5. OTHER INFORMATION**

On May 23, 2005 the Registrant issued a press release regarding the establishment of Wilshire Texas Partners I, LLC, the fifteenth certified capital company under its management. (See [Exhibit 99.1](#))

On June 10, 2005 the Registrant issued a press release regarding the appointment of Michael J. Holden as Chief Financial Officer and Senior Finance Executive effective as of June 10, 2005. (See [Exhibit 99.2](#))

On June 28, 2005 the Registrant issued a press release regarding the announcement that it has joined the new Russell Microcap Index when Russell Investment Group reconstituted its family of U.S. indexes on June 24. (See [Exhibit 99.3](#))

On July 5, 2005 the Registrant issued a press release regarding the signing of a \$75 million dollar commitment with GE Commercial Finance for a senior secured revolving line of credit. (See [Exhibit 99.4](#))

On July 27, 2005 the Registrant announced it had raised \$23.4 million in funding for its Texas certified capital company.

## **ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits attached to this Quarterly Report on Form 10-Q are:

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Exhibit 31.1: Certification of the Chief Executive Officer

Exhibit 32.1: Certification pursuant to 18 USC (Section) 1350.

Exhibit 99.1: Press Release, May 23, 2005

Exhibit 99.2: Press Release, June 10, 2005.

Exhibit 99.3: Press Release, June 28, 2005.

Exhibit 99.4: Press Release, July 5, 2005.

Exhibit 99.5: Press Release, July 27, 2005.

**Table of Contents**

(b) During the quarter ended June 30, 2005 we filed the following Current Reports on Form 8-K:

May 6, 2005: Announcement that a subsidiary, Newtek Small Business Finance, Inc., executed a nonexclusive Summary of Proposed Terms with a large, international commercial finance company for a \$75 million Senior Secured Revolving Credit Facility.

May 13, 2005: Announcement of receipt of a commitment letter to obtain a credit enhancement for the notes of its newly formed Texas certified capital company, Wilshire Texas Partners I, LLC.

June 9, 2005: Announcement of the resignation of Brian A. Wasserman as Chief Financial Officer and as a Director and announcement of appointment of Michael J. Holden as Chief Financial Officer and Senior Finance Executive effective as of June 10, 2005.

June 29, 2005: Announcement that a subsidiary, Newtek Small Business Finance, Inc., executed an amendment to its Master Loan and Security Agreement with DB Structured Products, Inc., providing for an extension of Newtek Small Business Finance, Inc.'s warehouse credit line to September 30, 2005.

**Table of Contents**

**SIGNATURES**

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

**NEWTEK BUSINESS SERVICES, INC.**

Date: August 22, 2005

/s/ Barry Sloane

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Barry Sloane  
Chairman of the Board, Chief Executive Officer  
and Secretary