NEWTEK BUSINESS SERVICES, INC.
Form 10-Q
May 12, 2014
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

OR

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

For the transition period from __________ to __________

Commission File Number: 001-16123

NEWTEK BUSINESS SERVICES, INC.

(Exact name of registrant as specified in its charter)

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

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

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

As of May 7, 2014, there were 36,966,672 of the Company s Common Shares outstanding.

Table of Contents

CONTENTS

	PAGE
PART I - FINANCIAL INFORMATION	
Item 1. Financial Statements:	
Condensed Consolidated Statements of Income (Unaudited) for the Three Months Ended March 31, 2014 and 2013	3
Condensed Consolidated Balance Sheets as of March 31, 2014 (Unaudited) and December 31, 2013	4
Condensed Consolidated Statements of Cash Flows (Unaudited) for the Three Months Ended March 31, 2014 and 2013	5
Notes to Condensed Consolidated Financial Statements (Unaudited)	7
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	28
Item 3. Quantitative and Qualitative Disclosures about Market Risk	41
Item 4. Controls and Procedures	42
PART II - OTHER INFORMATION	
Item 1. Legal Proceedings	43
Item 6. Exhibits	43
Signatures	44

Table of Contents

Item 1. Financial Statements.

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31, 2014 AND 2013

(In Thousands, except for Per Share Data)

	Three Months Ended March 31, 2014	2013
Operating revenues		
Electronic payment processing	$ 21,527	$ 21,677
Web hosting and design	3,987	4,380
Premium income	5,137	4,259
Interest income	1,561	1,030
Servicing fee income NSBF portfolio	832	614
Servicing fee income external portfolios	1,793	847
Income from tax credits	13	26
Insurance commissions	385	444
Other income	852	867
Total operating revenues	$ 36,087	$ 34,144
Net change in fair value of:		
SBA loans	(1,266)	(376)
Credits in lieu of cash and notes payable in credits in lieu of cash	1	19
Total net change in fair value	(1,265)	(357)
Operating expenses:		
Electronic payment processing costs	18,362	18,284
Salaries and benefits	6,478	6,056
Interest	1,636	1,303
Depreciation and amortization	855	807
Provision for loan losses	(205)	118
Other general and administrative costs	5,480	5,017
Total operating expenses	32,606	31,585
Income before income taxes	2,216	2,202
Provision for income taxes	(849)	(897)

Net income	1,367	1,305
Net loss attributable to non-controlling interests	24	147
Net income attributable to Newtek Business Services, Inc.	$ 1,391	$ 1,452
Weighted average common shares outstanding - basic	35,432	35,218
Weighted average common shares outstanding - diluted	38,386	37,736
Earnings per share basic and diluted	$ 0.04	$ 0.04

See accompanying notes to these unaudited condensed consolidated financial statements.

Table of Contents

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

MARCH 31, 2014 AND DECEMBER 31, 2013

(In Thousands, except for Per Share Data)

	March 31, 2014 Unaudited	December 31, 2013 (Note 1)
ASSETS		
Cash and cash equivalents	$ 10,234	$ 12,508
Restricted cash	10,569	16,877
Broker receivable	12,907	13,606
SBA loans held for investment, net (includes $10,311 and $10,894, respectively, related to securitization trust VIE; net of reserve for loan losses of $1,553 and $1,811, respectively)	10,237	10,689
SBA loans held for investment, at fair value (includes $82,368 and $74,387, respectively, related to securitization trust VIE)	87,670	78,951
Accounts receivable (net of allowance of $1,161 and $871, respectively)	11,638	11,602
SBA loans held for sale, at fair value	3,924	4,734
Prepaid expenses and other assets, net (includes $2,095 and $2,187, respectively, related to securitization trust VIE)	13,671	18,549
Servicing asset (net of accumulated amortization and allowances of $8,257 and $7,909, respectively)	7,287	6,776
Fixed assets (net of accumulated depreciation and amortization of $10,995 and $10,547, respectively)	3,844	3,741
Intangible assets (net of accumulated amortization of $2,198 and $2,243, respectively)	1,219	1,240
Credits in lieu of cash	3,231	3,641
Deferred tax asset, net	3,925	3,606
Goodwill	12,092	12,092
Total assets	$ 192,448	$ 198,612
LIABILITIES AND EQUITY		
Liabilities:		
Accounts payable, accrued expenses and other liabilities	$ 13,808	$ 14,688
Notes payable	37,227	41,218
Note payable securitization trust VIE	57,786	60,140
Capital lease obligation	585	642
Deferred revenue	1,312	1,274
Notes payable in credits in lieu of cash	3,231	3,641

Total liabilities	113,949	121,603
Commitments and contingencies		
Equity:		
Newtek Business Services, Inc. shareholders equity:		
Preferred shares (par value $0.02 per share; authorized 1,000 shares, no shares issued and outstanding)		
Common shares (par value $0.02 per share; authorized 54,000 shares, 36,913 issued; 35,451 and 35,385 outstanding, respectively, not including 83 shares held in escrow)	738	738
Additional paid-in capital	61,469	61,349
Retained earnings	15,927	14,536
Treasury shares, at cost (1,461 and 1,528, respectively)	(1,242)	(1,279)
Total Newtek Business Services, Inc. shareholders equity	76,892	75,344
Non-controlling interests	1,607	1,665
Total equity	78,499	77,009
Total liabilities and equity	$ 192,448	$ 198,612

See accompanying notes to these unaudited condensed consolidated financial statements.

4

Table of Contents

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31, 2014 AND 2013

(In Thousands)

	2014	2013
Cash flows from operating activities:		
Condensed consolidated net income	$ 1,367	$ 1,305
Adjustments to reconcile condensed consolidated net income to net cash (used in) provided by operating activities:		
Income from tax credits	(13)	(26)
Accretion of interest expense	14	46
Fair value adjustments on SBA loans	1,266	376
Fair value adjustment of credits in lieu of cash and notes payable in credits in lieu of cash	(1)	(19)
Deferred income taxes	(319)	(311)
Depreciation and amortization	855	807
Accretion of discount	70	(34)
Provision for loan losses	(205)	118
Other, net	643	309
Changes in operating assets and liabilities:		
Originations of SBA loans held for sale	(34,224)	(27,238)
Proceeds from sale of SBA loans held for sale	34,955	25,111
Broker receivable	700	(791)
Accounts receivable	(263)	(2,784)
Prepaid expenses, accrued interest receivable and other assets	4,636	(240)
Accounts payable, accrued expenses and deferred revenue	(778)	2,052
Other, net	(875)	(1,208)
Net cash provided by (used in) operating activities	7,828	(2,527)
Cash flows from investing activities:		
(Investment in) return of investments in qualified businesses	(72)	970
Purchase of fixed assets	(588)	(564)
SBA loans originated for investment, net	(11,385)	(7,640)
Payments received on SBA loans	2,159	1,201
Change in restricted cash		(1,290)
Other, net		15
Net cash used in investing activities	(9,886)	(7,308)

See accompanying notes to these unaudited condensed consolidated financial statements.

5

Table of Contents

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31, 2014 AND 2013 (CONTINUED)

(In Thousands)

	2014	2013
Cash flows from financing activities:		
Net repayments on bank lines of credit	$ (3,977)	$ (6,530)
Repayments on bank term note payable	(104)	(104)
Issuance of senior notes, net of issuance costs		20,962
Repayments of senior notes	(2,355)	(1,215)
Additions to deferred financing costs	(11)	(808)
Change in restricted cash related to securitization	6,323	(4,898)
Other	(92)	197
Net cash (used in) provided by financing activities	(216)	7,604
Net decrease in cash and cash equivalents	(2,274)	(2,231)
Cash and cash equivalents - beginning of period	12,508	14,229
Cash and cash equivalents - end of period	$ 10,234	$ 11,998
Supplemental disclosure of cash flow activities:		
Reduction of credits in lieu of cash and notes payable in credits in lieu of cash balances	$ 417	$ 2,819

See accompanying notes to these unaudited condensed consolidated financial statements.

Table of Contents

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION:

Newtek Business Services, Inc. (Newtek) is a holding company for several wholly- and majority-owned subsidiaries, including twelve certified capital companies which are referred to as Capcos, and several portfolio companies in which the Capcos own non-controlling or minority interests. The Company provides a one-stop-shop for business services to the small- and medium-sized business market and uses state of the art web-based proprietary technology to be a low cost acquirer and provider of products and services. The Company partners with companies, credit unions, and associations to offer its services.

The Company s principal business segments are:

Electronic Payment Processing: Marketing third party credit card processing and check approval services to the small- and medium-sized business market under the name of Newtek Merchant Solutions.

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

Small Business Finance: The segment is comprised of Newtek Small Business Finance, Inc. (NSBF), a nationally licensed, U.S. Small Business Administration (SBA) lender that originates, sells and services loans to qualifying small businesses, which are partially guaranteed by the SBA and CDS Business Services, Inc. d/b/a Newtek Business Credit (NBC) which provides receivable financing and management services.

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

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

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

The condensed consolidated financial statements of Newtek, its subsidiaries and consolidated entities included herein have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America and include all wholly- and majority-owned subsidiaries, and several portfolio companies in which the Capcos own non-controlling minority interest in, or those variable interest entities of which Newtek is considered to be the primary beneficiary. All inter-company balances and transactions have been eliminated in consolidation. Non-controlling interests are reported below net income (loss) under the heading Net (income) loss attributable to non-controlling interests in the condensed consolidated statements of income (unaudited) and shown as a component of equity in the condensed consolidated balance sheets.

The accompanying notes to unaudited condensed consolidated financial statements should be read in conjunction with Newtek s 2013 Annual Report on Form 10-K. These financial statements have been prepared in accordance with instructions to Form 10-Q and Article 10 of Regulation S-X and, therefore, omit or condense certain footnotes and other information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States. In the opinion of management, all adjustments, consisting of normal recurring items, considered necessary for a fair presentation have been included. The results of operations for an interim period may not give a true indication of the results for the entire year. The December 31, 2013 condensed consolidated balance sheet has been derived from the audited financial statements of that date but does not include all disclosures required by accounting principles generally accepted in the United States of America.

All financial information included in the tables in the following footnotes is stated in thousands, except per share data.

Table of Contents

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES:

Use of Estimates

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

Revenue Recognition

The Company operates in a number of different segments. Revenues are recognized as services are rendered and are summarized as follows:

Electronic payment processing revenue: Electronic payment processing and fee income is derived from the electronic processing of credit and debit card transactions that are authorized and captured through third-party networks. Typically, merchants are charged for these processing services on a percentage of the dollar amount of each transaction plus a flat fee per transaction. Certain merchant customers are charged miscellaneous fees, including fees for handling charge-backs or returns, monthly minimum fees, statement fees and fees for other miscellaneous services. Revenues derived from the electronic processing of MasterCard® and Visa® sourced credit and debit card transactions are reported gross of amounts paid to sponsor banks.

Web hosting revenue: Managed technology solutions revenue is primarily derived from monthly recurring service fees for the use of its web hosting, web design and software support services. Customer set-up fees are billed upon service initiation and are recognized as revenue over the estimated customer relationship period of 2.5 years. Payment for web hosting and related services, excluding cloud plans, is generally received one month to one year in advance. Deferred revenues represent customer payments for web hosting, web design and related services in advance of the reporting period date. Revenue for cloud related services is based on actual consumption used by a cloud customer.

Sales and Servicing of SBA Loans: NSBF originates loans to customers under the SBA program that generally provides for SBA guarantees of 75% to 90% of each loan, subject to a maximum guarantee amount. This guaranteed portion is generally sold to a third party via an SBA regulated secondary market transaction utilizing SBA Form 1086 for a price equal to the guaranteed loan amount plus a premium. NSBF recognizes premium on loan sales as equal to the cash premium plus the fair value of the initial servicing asset. Revenue is recognized on the trade date of the guaranteed portion.

Upon recognition of each loan sale, the Company retains servicing responsibilities and receives servicing fees of a minimum of 1% of the guaranteed loan portion sold. The Company is required to estimate its adequate servicing compensation in the calculation of its servicing asset. The purchasers of the loans sold have no recourse to the Company for failure of customers to pay amounts contractually due.

Subsequent measurements of each class of servicing assets and liabilities may use either the amortization method or the fair value measurement method. NSBF has chosen to apply the amortization method to its servicing asset, amortizing the asset in proportion to, and over the period of, the estimated future net servicing income on the underlying sold guaranteed portion of the loans and assessing the servicing asset for impairment based on fair value if and when a triggering event occurs. In the event future prepayments are significant or impairments are incurred and future expected cash flows are inadequate to cover the unamortized servicing assets, additional amortization or impairment charges would be recognized. In evaluating and measuring impairment of servicing assets, NSBF stratifies its servicing assets based on year of loan and loan term which are the key risk characteristics of the underlying loan pools. The Company uses an independent valuation specialist to estimate the fair value of the servicing asset by calculating the present value of estimated future net servicing cash flows, using assumptions of prepayments, defaults, servicing costs and discount rates that NSBF believes market participants would use for similar assets. If NSBF determines that the impairment for a stratum is temporary, a valuation allowance is recognized through a charge to current earnings for the amount the amortized balance exceeds the current fair value. If the fair value of the stratum were to later increase, the valuation allowance may be reduced as a recovery. However, if NSBF determines that impairment for a stratum is other than temporary, the value of the servicing asset and any related valuation allowance is written-down.

SBA Loan Interest and Fees: Interest income on loans is recognized as earned. A loan is placed on non-accrual status if it exceeds 90 days past due with respect to principal or interest and, in the opinion of management, interest or principal on the loan is not

Table of Contents

collectible, or at such earlier time as management determines that the collectability of such principal or interest is unlikely. Such loans are designated as impaired non-accrual loans. All other loans are defined as performing loans. When a loan is designated as impaired, the accrual of interest is discontinued, and any accrued but uncollected interest income is reversed and charged against current operations. While a loan is classified as impaired and the future collectability of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The Company passes certain expenditures it incurs to the borrower, such as force placed insurance, insufficient funds fees, or fees it assesses, such as late fees, with respect to managing the loan. These expenditures are recorded when incurred. Due to the uncertainty with respect to collection of these passed through expenditures or assessed fees, any funds received to reimburse the Company are recorded on a cash basis as other income.

Income from tax credits: Following an application process, a state will notify a company that it has been certified as a Capco. The state or jurisdiction then allocates an aggregate dollar amount of tax credits to the Capco. However, such amount is neither recognized as income nor otherwise recorded in the financial statements since it has yet to be earned by the Capco. The Capco is entitled to earn tax credits upon satisfying defined investment percentage thresholds within specified time requirements. Newtek has Capcos operating in five states and the District of Columbia. Each statute requires that the Capco invest a threshold percentage of certified capital (the funds provided by the insurance company investors) in businesses defined as qualified within the time frames specified. As the Capco meets these requirements, it avoids grounds under the statute for its disqualification for continued participation in the Capco program. Such a disqualification, or decertification as a Capco results in a permanent recapture of all or a portion of the allocated tax credits. The proportion of the possible recapture is reduced over time as the Capco remains in general compliance with the program rules and meets the progressively increasing investment benchmarks. As the Capco progresses in its investments in Qualified Businesses and, accordingly, places an increasing proportion of the tax credits beyond recapture, it earns an amount equal to the non-recapturable tax credits and records such amount as income, with a corresponding asset called credits in lieu of cash in the balance sheet.

The amount earned and recorded as income is determined by multiplying the total amount of tax credits allocated to the Capco by the percentage of tax credits immune from recapture (the earned income percentage) at that point. To the extent that the investment requirements are met ahead of schedule, and the percentage of non-recapturable tax credits is accelerated, the present value of the tax credit earned is recognized currently and the asset, credits in lieu of cash, is accreted up to the amount of tax credits deliverable to the certified investors. The obligation to deliver tax credits to the certified investors is recorded as notes payable in credits in lieu of cash. On the date the tax credits are utilizable by the certified investors, the Capco decreases credits in lieu of cash with a corresponding decrease to notes payable in credits in lieu of cash.

Insurance commissions: Revenues are comprised of commissions earned on premiums paid for insurance policies and are recognized at the time the commission is earned. At that date, the earnings process has been completed and the Company can estimate the impact of policy cancellations for refunds and establish reserves. The reserve for policy cancellations is based on historical cancellation experience adjusted by known circumstances.

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

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

Late fees: Late fees are derived from receivables NBC has purchased that have gone over a certain period (usually over 30 days) without payment. The client or the client s customer is charged a late fee according to the agreement with the client and NBC records the fees as income in the month in which such receivable becomes past due.

Billing fees: Billing fees are derived from billing-only (non-finance) clients. These fees are recorded when earned, which occurs when the service is rendered.

Other fees: These fees include re-underwriting fees, due diligence fees, termination fees, under minimum fees, and other fees including finance charges, supplies sold to clients, NSF fees, wire fees and administration fees. These fees are charged upon funding, takeovers or liquidation of finance clients. The Company also receives commission revenue from various sources.

Table of Contents

Electronic Payment Processing Costs

Electronic payment processing costs consist principally of costs directly related to the processing of merchant sales volume, including interchange fees, VISA® and MasterCard® dues and assessments, bank processing fees and costs paid to third-party processing networks. Such costs are recognized at the time the merchant transactions are processed or when the services are performed. Two of the most significant components of electronic processing expenses include interchange and assessment costs, which are set by the credit card associations. Interchange costs are passed on to the entity issuing the credit card used in the transaction and assessment costs are retained by the credit card associations. Interchange and assessment fees are billed primarily as a percent of dollar volume processed or, to a lesser extent, as a per transaction fee. In addition to costs directly related to the processing of merchant sales volume, electronic payment processing costs also include residual expenses, which represent fees paid to third-party sales referral sources. Residual expenses are paid under various formulae as contracted. These are generally linked to revenues derived from merchants successfully referred to the Company and that begin using the Company for merchant processing services.

Restricted Cash

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

(In thousands):	March 31, 2014	December 31, 2013
Electronic payment processing	$ 571	$ 573
Small business finance	6,810	12,829
All other	2,187	2,475
Corporate activities	990	989
Capcos	11	11
Totals	$ 10,569	$ 16,877

Broker Receivable

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

SBA Loans Held for Investment

For loans that completed funding before October 1, 2010, SBA loans held for investment are reported at their outstanding unpaid principal balances adjusted for charge-offs, net deferred loan origination costs and the allowance for loan losses. For loans that completed funding on or after October 1, 2010, management elected to fair value SBA loans held for investment within the fair value hierarchy that prioritizes observable and unobservable inputs utilizing

Level 3 unobservable inputs which reflect the Company s own expectations about the assumptions that market participants would use in pricing the asset (including assumptions about risk). Prior to 2013, the Company determined fair value based on its securitization pricing, as well as internal quantitative data on the portfolio with respect to historical default rates and future expected losses, and now uses a discounted cash flow method, which includes assumptions for cumulative default rates, prepayment speeds, servicing cost and a market yield.

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

Table of Contents

Allowance for SBA Loan Losses

For loans funded before October 1, 2010, the allowance for loan losses for performing loans is established by management through provisions for loan losses charged against income. The amount of the allowance for loan losses is inherently subjective, as it requires making material estimates which may vary from actual results. Management s ongoing estimates of the allowance for loan losses are particularly affected by the changing composition of the loan portfolio over the last few years as well as other portfolio characteristics, such as industry concentrations and loan collateral. The adequacy of the allowance for loan losses is reviewed by management on a monthly basis at a minimum, and as adjustments become necessary, are reflected in operations during the periods in which they become known. Considerations in this evaluation include past and anticipated loss experience, risks inherent in the current portfolio and evaluation of real estate collateral as well as current economic conditions. In the opinion of management, the allowance, when taken as a whole, is adequate to absorb estimated loan losses inherent in the Company s entire loan portfolio. The allowance consists of specific and general reserves. The specific reserves relate to loans that are classified as either loss, doubtful, substandard or special mention that are considered impaired. An allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors.

Loans funded on or after October 1, 2010 are recorded at fair value. Changes in the value of such loans, whether performing or impaired, are reported as a net change in the fair value of SBA loans held for investment in the consolidated statement of operations.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement, and includes troubled debt restructured loans. Other factors considered by management in determining impairment include payment status and collateral value. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan s market interest rate, or the fair value of the collateral less estimated costs to sell, if the loan is collateral dependent. Impaired loans for which the carrying amount is based on fair value of the underlying collateral are included in assets and reported at estimated fair value on a non-recurring basis, both at initial recognition of impairment and on an on-going basis until recovery or charge-off of the loan amount. The determination of impairment involves management s judgment in the use of market data and third party estimates regarding collateral values. For loans funded before October 1, 2010, the impairment of a loan resulted in management establishing an allowance for loan losses through provisions for loan losses charged against income; for subsequent loans at fair value, impairment results in a net change in the fair value of SBA loans held for investment. Amounts deemed to be uncollectible are charged against the allowance for loan losses or reduces the fair value and subsequent recoveries, if any, are credited to the allowance or increases the fair value.

The Company s charge-off policy is based on a loan-by-loan review for which the estimated uncollectible portion of nonperforming loans is charged off against the corresponding loan receivable and the allowance for possible loan losses or against the reduction in fair value.

Troubled Debt Restructured Loans

A loan is considered a troubled debt restructuring, (TDR) when a borrower is experiencing financial difficulties that lead to a restructuring that the Company would not otherwise consider. Concessions per Accounting Standards Codification, (ASC) Topic 310, Receivables, may include rate reductions, principal forgiveness, extension of the maturity date and other actions to minimize potential losses. All TDRs are modified loans; however, not all modified loans are TDRs.

The Company reviews its modified loans for TDR classification. When a borrower is granted extended time to pay and there are no other concessions as to rate reductions or principal, the loan remains an accrual loan. Certain time extensions based on the time value of money require reserves to be established despite no interruption on payments being made. In the case of a default, the loan becomes non-accrual and reviewed by committee for adequate specific reserves to that loan.

SBA Loans Held For Sale

For guaranteed portions funded, but not yet traded at each measurement date, management elected to fair value SBA loans held for sale within the fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value utilizing

Level 2 assets. These inputs include debt securities with quoted prices that are traded less frequently than exchange-traded instruments or have values determined using a pricing model with inputs that are observable in the market. The secondary market for the guaranteed portions is extremely robust with broker dealers acting as primary dealers. NSBF sells regularly into the market and can quickly price its loans held for sale. The Company values the guaranteed portion based on observable market prices for similar assets.

Loans receivable held for sale are sold with the servicing rights retained by the Company. For loans funded prior to October 1, 2010, gains on sales of loans are recognized based on the difference between the selling price and the carrying value of the related loans sold. Unamortized net deferred loan origination costs are recognized as a component of gain on sale of loans. For loans funded on or after October 1, 2010, premium on loan sales is equal to the cash premium plus the fair value of the servicing asset while reversing the fair value gain previously recorded.

Purchased Receivables

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

Investments in Qualified Businesses

The various interests that the Company acquires in its qualified investments are accounted for under three methods: consolidation, equity method and cost method. The applicable accounting method is generally determined based on the Company s voting interest or the economics of the transaction if the investee is determined to be a variable interest entity.

Consolidation Method. Investments in which the Company directly or indirectly owns more than 50% of the outstanding voting securities, those the Company has effective control over, or those deemed to be a variable interest entity in which the Company is the primary beneficiary are generally accounted for under the consolidation method of accounting. Under this method, an investment s financial position and results of operations are reflected within the Company s condensed consolidated financial statements. All significant inter-company accounts and transactions are eliminated, including returns of principal, dividends, interest received and investment redemptions. The results of operations and cash flows of a consolidated operating entity are included through the latest interim period in which the Company owned a greater than 50% direct or indirect voting interest, exercised control over the entity for the entire interim period or was otherwise designated as the primary beneficiary. Upon dilution of control below 50%, or upon occurrence of a triggering event requiring reconsideration as to the primary beneficiary of a variable interest entity, the accounting method is adjusted to the equity or cost method of accounting, as appropriate, for subsequent periods.

Equity Method. Investments that are not consolidated, but over which the Company exercises significant influence, are accounted for under the equity method of accounting. Whether or not the Company exercises significant influence with respect to an investee depends on an evaluation of several factors including, among others, representation on the investee s Board of Directors and ownership level, which is generally a 20% to 50% interest in the voting securities of the investee, including voting rights associated with the Company s holdings in common, preferred and other convertible instruments in the investee. Under the equity method of accounting, an investee s accounts are not reflected within the Company s condensed consolidated financial statements; however, the Company s share of the earnings or losses of the investee is reflected in the Company s condensed consolidated financial statements.

Cost Method. Investments not accounted for under the consolidation or the equity method of accounting are accounted for under the cost method of accounting. Under this method, the Company s share of the net earnings or losses of such investments is not included in the Company s condensed consolidated financial statements. However, cost method impairment charges are recognized, as necessary, in the Company s condensed consolidated financial statements. If circumstances suggest that the value of the investee has subsequently recovered, such recovery is not recorded until ultimately liquidated or realized.

The Company s debt and equity investments have substantially been made with funds available to Newtek through the Capco programs. These programs generally require that each Capco meet a minimum investment benchmark within five years of initial funding. In addition, any funds received by a Capco as a result of a debt repayment or equity return may, under the terms of the Capco programs, be reinvested and counted towards the Capcos minimum investment benchmarks.

Securitization Activities

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

Table of Contents

Share - Based Compensation

All share-based payments to employees are recognized in the financial statements based on their fair values using an option-pricing model at the date of grant. The Company recognizes compensation on a straight-line basis over the requisite service period for the entire award. The Company has elected to adopt the alternative transition method for calculating the tax effects of share-based compensation. The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool related to the tax effects of employee share-based compensation, which is available to absorb tax deficiencies.

Fair Value

ASC Topic 820 stipulates a fair value hierarchy based on whether the inputs to valuation techniques utilized to measure fair value are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Company-based assumptions. The Company adopted the methods of fair value to value its financial assets and liabilities. The Company carries its credits in lieu of cash, prepaid insurance and notes payable in credits in lieu of cash at fair value, as well as its SBA loans held for investment and SBA loans held for sale. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In accordance with ASC Topic 820 and in order to increase consistency and comparability in fair value measurements, the Company utilized a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain U.S. Government and agency mortgage-backed debt securities, corporate debt securities, derivative contracts and residential mortgage loans held-for-sale.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly structured or long-term derivative contracts.

Income Taxes

Deferred tax assets and liabilities are computed based upon the differences between the financial statement and income tax basis of assets and liabilities using the enacted tax rates in effect for the year in which those temporary differences are expected to be realized or settled. If available evidence suggests that it is more likely than not that some portion or all of the deferred tax assets will not be realized, a valuation allowance is required to reduce the deferred tax assets to the amount that is more likely than not to be realized.

The Company s U.S. Federal and state income tax returns prior to fiscal year 2010 are closed and management continually evaluates expiring statutes of limitations, audits, proposed settlements, changes in tax law and new authoritative rulings.

Accounting for Uncertainty in Income Taxes

The ultimate deductibility of positions taken or expected to be taken on tax returns is often uncertain. In order to recognize the benefits associated with a tax position taken (i.e., generally a deduction on a corporation s tax return), the entity must conclude that the ultimate allowability of the deduction is more likely than not. If the ultimate allowability of the tax position exceeds 50%

(i.e., it is more likely than not), the benefit associated with the position is recognized at the largest dollar amount that has more than a 50% likelihood of being realized upon ultimate settlement. Differences between tax positions taken in a tax return and recognized will generally result in (1) an increase in income taxes currently payable or a reduction in an income tax refund receivable or (2) an increase in a deferred tax liability or a decrease in a deferred tax asset, or both (1) and (2).

Fair Value of Financial Instruments

As required by the Financial Instruments Topic of the Financial Accounting Standards Board (FASB) ASC Topic 820, the estimated fair values of financial instruments must be disclosed. Excluding fixed assets, intangible assets, goodwill, and prepaid expenses and other assets (noted below), substantially all of the Company s assets and liabilities are considered financial instruments as defined under this standard. Fair value estimates are subjective in nature and are dependent on a number of significant assumptions associated with each instrument or group of similar instruments, including estimates of discount rates, risks associated with specific financial instruments, estimates of future cash flows and relevant available market information.

The carrying values of the following balance sheet items approximate their fair values primarily due to their liquidity and short-term or adjustable-yield nature:

Cash and cash equivalents

Restricted cash

Broker receivable

Accounts receivable

Notes payable

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

Accrued interest payable (included in Accounts payable, accrued expenses and other liabilities)

Accounts payable and accrued expenses

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

New Accounting Standards

In January 2014, the FASB issued ASU 2014-04, Receivables Troubled Debt Restructurings by Creditors: Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force). The update clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The ASU is effective for fiscal years and interim periods beginning after December 15, 2014. The adoption of this ASU is not expected to have a significant impact on the Company s Consolidated Financial Statements or disclosures.

NOTE 3 FAIR VALUE MEASUREMENTS:

Fair Value Option Elections

Effective January 1, 2008, the Company adopted fair value accounting concurrent with the election of the fair value option. The accounting standard relating to the fair value measurements clarifies the definition of fair value and describes methods available to appropriately measure fair value in accordance with GAAP. The accounting standard applies whenever other accounting standards require or permit fair value measurements. The accounting standard relating to the fair value option for financial assets and financial liabilities allows entities to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities that are not otherwise required to be measured at fair value, with changes in fair value recognized in earnings as they occur. It also establishes presentation and disclosure requirements designed to improve comparability between entities that elect different measurement attributes for similar assets and liabilities.

On January 1, 2008, the Company elected the fair value option for valuing its Capcos credits in lieu of cash, notes payable in credits in lieu of cash and prepaid insurance.

Table of Contents

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

The Company elected the fair value option in order to reflect in its financial statements the assumptions that market participants use in evaluating these financial instruments.

Assets and Liabilities Measured at Fair Value on a Recurring Basis:

	Fair Value Measurements at March 31, 2014 Using:				
(In thousands):	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total Unrealized Gains and (Losses)**
Assets					
Credits in lieu of cash	$ 3,231	$	$ 3,231	$	$
SBA loans held for investment	87,670			87,670	(1,187)
SBA loans held for sale	3,924		3,924		(79)
Total assets	$ 94,825	$	$ 7,155	$ 87,670	$ (1,266)
Liabilities					
Notes payable in credits in lieu of cash	$ 3,231	$	$ 3,231	$	$ 1

Assets and Liabilities Measured at Fair Value on a Recurring Basis:

	Fair Value Measurements at December 31, 2013 Using:				
(In thousands):	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total Unrealized Gains and (Losses)**
Assets					
Credits in lieu of cash	$ 3,641	$	$ 3,641	$	$
SBA loans held for investment	78,951			78,951	(1,629)
SBA loans held for sale	4,734		4,734		403

Total assets	$ 87,326	$	$ 8,375	$ 78,951	$ (1,226)
Liabilities					
Notes payable in credits in lieu of cash	$ 3,641	$	$ 3,641	$	$ 21
Total liabilities	$ 3,641	$	$ 3,641	$	$ 21

Fair value measurements:

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

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

The Company s Capcos debt, enhanced by Chartis insurance, effectively bears the nonperformance risk of Chartis. The closest trading comparators are the debt of Chartis parent, AIG. Therefore the Company calculates the fair value of both the credits in lieu of cash and notes payable in credits in lieu of cash using the yields of various AIG notes with similar maturities to each of the Company s respective Capcos debt (the Chartis Note Basket). The Company elected to discontinue utilizing AIG s 7.70% Series A-5 Junior Subordinated Debentures because those long maturity notes began to trade with characteristics of a preferred stock after AIG received financing from the United States Government. The Company considers the Chartis Note Basket a Level 2 input under fair value accounting, since it is a quoted yield for a similar liability that is traded in an active exchange market. The Company selected the Chartis Note Basket as the most representative of the nonperformance risk associated with the Capco notes because they are Chartis issued notes, are actively traded and because maturities match credits in lieu of cash and notes payable in credits in lieu of cash.

After calculating the fair value of both the credits in lieu of cash and notes payable in credits in lieu of cash, the Company compares their values. This calculation is done on a quarterly basis. Calculation differences primarily due to tax credit receipt versus delivery timing may cause the value of the credits in lieu of cash to differ from that of the notes payable in credits in lieu of cash. Because the credits in lieu of cash asset has the single purpose of paying the notes payable in credits in lieu of cash and has no other value to the Company, Newtek determined that the credits in lieu of cash should equal the notes payable in credits in lieu of cash.

On December 31, 2013, the yield on the Chartis Note Basket was 1.49%. As of March 31, 2014, the date the Company revalued the asset and liability, the yields on the Chartis notes averaged 1.63% reflecting changes in interest rates in the marketplace. This increase in yield increased both the fair value of the credits in lieu of cash and the fair value of the notes payable in credits in lieu of cash. The Company increased the value of the credits in lieu of cash to equal the value of the notes payable in credits in lieu of cash because the credits in lieu of cash can only be used to satisfy the liability and must equal the value of the notes payable in credits in lieu of cash at all times. For the three months ended March 31, 2014, the Company reported a gain of $1,000.

On December 31, 2012, the yield on the Chartis Note Basket was 1.72%. As of March 31, 2013, the date the Company revalued the asset and liability, the yields on the Chartis notes averaged 1.80% reflecting changes in interest rates in the marketplace. This increase in yield increased both the fair value of the credits in lieu of cash and the fair value of the notes payable in credits in lieu of cash. The Company decreased the value of the credits in lieu of cash to equal the value of the notes payable in credits in lieu of cash because the credits in lieu of cash can only be used to satisfy the liability and must equal the value of the notes payable in credits in lieu of cash at all times. The net change in fair value reported in the Company s condensed consolidated statements of income for the three months ended March 31, 2013 was a gain of $19,000.

Changes in the future yield of the Chartis Note Basket will result in changes to the fair values of the credits in lieu of cash and notes payable in credits in lieu of cash when calculated for future periods; these changes will be reported through the Company s condensed consolidated statements of income.

SBA 7(a) Loans

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

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

SBA Loans Held for Investment

For loans that completed funding before October 1, 2010, SBA loans held for investment are reported at their outstanding unpaid principal balances adjusted for charge-offs, net deferred loan origination costs and the allowance for loan losses. For loans that completed funding on or after October 1, 2010, management elected to fair value SBA loans held for investment within the fair value hierarchy that prioritizes observable and unobservable inputs utilizing Level 3 unobservable inputs which reflect the Company s own expectations about the assumptions that market participants would use in pricing the asset (including assumptions about risk).

In determining the net change in fair value of loans held for investment for the three months ended March 31, 2014, the Company used a discounted cash flow model which incorporated a series of expected future cash flows for the performing SBA 7(a) loan portfolio, and discounts those cash flows at a market clearing yield of 5.38%. The key assumptions used in the model are considered unobservable inputs and include anticipated prepayment speeds, cumulative default rates, the cost of loan servicing, and Prime rate expectations. The Company used an assumed prepayment speed of 15% based on current market conditions and historical experience for the loan portfolio, against a prepayment curve developed from NSBF historical experience to calculate expected loan prepayments in a given year. Defaults are defined as any loan placed on non-accrual status as of March 31, 2014. The default rate, defined as the percent of loan balance that will enter final liquidation in a given year, was estimated to be 25%, and was derived from NSBF historical experience. The mix of NSBF s loan portfolio continues to shift from start-up businesses, to predominately originating to existing businesses. Our historical default and loss rates demonstrate that this particular segment (i.e. Existing Business) of our SBA loan portfolio continues to experience the lowest rate of defaults and ultimate losses over our nine year history of originating loans. When computing the cumulative default rate to be applied to the performing portfolio loan balances, the Company excluded the last three years of originations as those loans have not seasoned yet. The discounted cash flow resulted in a price equivalent of 93.97% of the par amount on our loans held for investment as of March 31, 2014.

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

Below is a summary of the activity in SBA loans held for investment, at fair value for the three months ended March 31, 2014 and the year ended December 31, 2013, respectively, (in thousands):

	Three Months Ended March 31, 2014	Year Ended December 31, 2013
Balance, beginning of period	$ 78,951	$ 43,055
SBA loans held for investment, originated	11,385	42,773
Loans transferred to other real estate owned		(362)
Payments received	(1,479)	(4,886)
Fair value loss	(1,187)	(1,629)
Balance, end of period	$ 87,670	$ 78,951

17

Table of Contents

SBA Loans Held For Sale

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

Other Fair Value Measurements

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

	Fair Value Measurements at March 31, 2014 Using:				
	Total	**Level 1**	**Level 2**	**Level 3**	**Total Losses**
Assets					
Impaired loans	$ 3,194	$	$	$ 3,194	$ (120)
Other real-estate owned	571		571		(20)
Total assets	$ 3,765	$	$ 571	$ 3,194	$ (140)

	Fair Value Measurements at December 31, 2013 Using:				
	Total	**Level 1**	**Level 2**	**Level 3**	**Total Losses**
Assets					
Impaired loans	$ 3,441	$	$	$ 3,441	$ (1,022)
Other real-estate owned	798		798		(182)
Total assets	$ 4,239	$	$ 798	$ 3,441	$ (1,204)

Impaired loans

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

Table of Contents

Other real-estate owned (included in Prepaid expenses and other assets)

The estimated fair value of other real-estate owned is calculated using observable market information, including bids from prospective purchasers and pricing from similar market transactions where available. The value is generally discounted between 20-25% based on market valuations as well as expenses associated with securing the Company s interests. Where bid information is not available for a specific property, the valuation is principally based upon recent transaction prices for similar properties that have been sold. These comparable properties share comparable demographic characteristics. Other real estate owned is generally classified within Level 2 of the valuation hierarchy.

NOTE 4 SBA LOANS:

SBA loans are geographically concentrated in New York (13.16%). Below is a summary of the activity in the SBA loans held for investment, net of SBA loan loss reserves for the three months ended March 31, 2014 (in thousands):

Balance at December 31, 2013	$ 89,640
SBA loans funded for investment	11,385
Fair value adjustment	(1,187)
Payments received	(2,159)
Provision for SBA loan losses	205
Discount on loan originations, net	23
Balance at March 31, 2014	$ 97,907

Below is a summary of the activity in the reserve for loan losses, cost basis, for the three months ended March 31, 2014 (in thousands):

Allowance for loan losses, cost basis:	
Balance, beginning of year	$ 1,811
Provision for loan losses	(205)
Loans charged-off	(59)
Recoveries	6
Balance, end of year	$ 1,553
Individually evaluated for impairment	$ 1,362
Collectively evaluated for impairment	191
Balance, end of year	$ 1,553
Total loans, cost basis	
Individually evaluated for impairment	$ 3,195
Collectively evaluated for impairment	9,409

Balance, end of year	$ 12,604

Below is a summary of the activity in the SBA loans held for sale for the three months ended March 31, 2014 (in thousands):

Balance at December 31, 2013	$ 4,734
Originations of SBA loans held for sale	34,224
Fair value adjustment	(79)
SBA loans sold	(34,955)
Balance at March 31, 2014	$ 3,924

All loans are priced at the Prime interest rate plus approximately 2.75% to 3.75%. The only loans with a fixed interest rate are defaulted loans of which the guaranteed portion sold is repurchased from the secondary market by the SBA, while the unguaranteed portion of the loans still remains with the Company. As of March 31, 2014 and December 31, 2013, SBA loans receivable held for investment with adjustable interest rates amounted to $99,399,000 and $91,083,000, respectively.

Table of Contents

For the three months ended March 31, 2014 and 2013, the Company funded approximately $45,680,000 and $34,826,000 in loans and sold approximately $34,955,000 and $27,238,000 of the guaranteed portion of the loans, respectively. Receivables from loans traded but not settled of $12,907,000 and $13,606,000 as of March 31, 2014 and December 31, 2013, respectively, are presented as broker receivable in the accompanying condensed consolidated balance sheets.

The outstanding balances of loans past due over ninety days and still accruing interest as of March 31, 2014 was approximately $843,000; there were no loans past due over ninety days and still accruing interest as of December 31, 2013.

At March 31, 2014 and December 31, 2013, total impaired loans amounted to $7,371,000 and $7,678,000, respectively. For the three months ended March 31, 2014 and for the year ended December 31, 2013, the average balance of impaired loans was $7,559,000 and $6,887,000, respectively, and approximately $1,362,000 and $1,609,000 in specific reserves included in the allowance for loan losses and $618,000 and $163,000 of SBA fair value discount were allocated against such impaired loans, respectively.

The following is a summary of SBA loans held for investment as of:

	March 31, 2014		**December 31, 2013**	
(in thousands):	**Fair Value**	**Cost Basis**	**Fair Value**	**Cost Basis**
Due in one year or less	$	$ 210	$	$ 319
Due between one and five years		4,404		4,509
Due after five years	93,894	7,990	83,988	8,513
Total	93,894	12,604	83,988	13,341
Less: Allowance for loan losses		(1,553)		(1,811)
Less: Deferred origination fees, net		(814)		(841)
Less: Fair value adjustment	(6,224)		(5,037)	
Balance (net)	$ 87,670	$ 10,237	$ 78,951	$ 10,689

The payment status of gross SBA loans held for investment is as follows:

	(in thousands)	
Days Past Due	**March 31, 2014**	**December 31, 2013**
Current	$ 92,116	$ 84,809
30 89	6,168	4,842
> 90	843	
Non-accrual	7,371	7,678
Balance (net)	$ 106,498	$ $97,329

The Company evaluates the credit quality of its loan portfolio by employing a risk rating system that is similar to the Uniform Classification System which is the asset classification system adopted by the Federal Financial Institution

Examinations Council. The Company s risk rating system is granular with multiple risk ratings in both the Acceptable and Substandard categories. Assignment of the ratings are predicated upon numerous factors, including credit risk scores, collateral type, loan to value ratios, industry, financial health of the business, payment history, other internal metrics/analysis, and qualitative assessments.

Table of Contents

Risk ratings are refreshed as appropriate based upon considerations such as market conditions, loan characteristics, and portfolio trends. The Company s gross SBA loans held for investment recorded at cost by credit quality indicator are as follows:

	(in thousands)	
Risk Rating	**March 31, 2014**	**December 31, 2013**
Acceptable	$ 7,149	$ 7,420
Other assets special mention	2,053	2,234
Substandard	3,141	3,283
Doubtful	252	395
Loss	9	9
Balance	$ 12,604	$ 13,341

The Company had loans renegotiated in troubled debt restructurings of $3,381,000 as of March 31, 2014, of which $1,477,000 was on non-accrual status and $1,904,000 was on accrual status. As of December 31, 2013, there was approximately $3,409,000 of loans renegotiated in trouble debt restructurings, of which $1,332,000 was included in non-accrual loans and $2,077,000 was on accrual status. The Company has no commitments to loan additional funds to borrowers whose existing loans have been modified in TDR.

An analysis of loans restructured in TDR for the periods ended March 31, 2014 and March 31, 2013, respectively, is as follows (in thousands):

Type of Concession	**March 31, 2014**		**March 31, 2013**	
	Number of Notes	**Principal Balance at Restructure Date**	**Number of Notes**	**Principal Balance at Restructure Date**
Payment reduction / Interest-only period	1	$ 63	1	$ 163

TDRs that return to a non-performing status post-modification are considered redefaulted loans and are treated in the same manner as other non-performing loans in the portfolio. For the period ended March 31, 2014, the Company had two TDR loans that subsequently defaulted with a corresponding principal balance of approximately $134,000, and one loan that was subsequently charged-off with a corresponding principal balance of approximately $ 24,000; for the period ended March 31, 2013, there were no TDR loans that subsequently defaulted or were charged-off.

NOTE 5 SERVICING ASSETS:

The Company reviews capitalized servicing assets for impairment. This review is performed based on risk strata, which are determined on a disaggregated basis given the predominant risk characteristics of the underlying loans. The predominant risk characteristics are loan terms and year of loan origination.

The following summarizes the activity pertaining to servicing assets for the three months ended March 31, 2014 (in thousands):

(in thousands):	
Balance at December 31, 2013	$ 6,776
Servicing rights capitalized	859
Servicing rights amortized	(348)
Balance at March 31, 2014	$ 7,287

The carrying value of the capitalized servicing assets was $7,287,000 and $6,776,000 at March 31, 2014 and December 31, 2013, respectively, while the estimated fair value of capitalized servicing rights was $8,649,000 and $7,959,000 at March 31, 2014 and December 31, 2013, respectively. The estimated fair value of servicing assets at March 31, 2014 was determined using a discount factor that equates the present value of the expected servicing income to the strip multiple method valuation rate of 9%, weighted average prepayment speeds ranging from 5% to 13%, depending upon certain characteristics of the loan portfolio, weighted average life of 4.33 years, and an average default rate of 4.6%.

The estimated fair value of servicing assets at December 31, 2013 was determined using a discount factor that equates the present value of the expected servicing income to the strip multiple method valuation rate of 11%, weighted average prepayment speeds ranging from 0% to 11%, depending upon certain characteristics of the loan portfolio, weighted average life of 5.00 years, and an average default rate of 3%.

Table of Contents

The unpaid principal balances of loans serviced for others are not included in the accompanying condensed consolidated balance sheets. The unpaid principal balances of loans serviced for others within the NSBF originated portfolio were $400,015,000 and $372,366,000 as of March 31, 2014 and December 31, 2013, respectively. The unpaid principal balances of loans serviced for others which were not originated by NSBF and are outside of the Newtek portfolio were $547,011,000 and $561,092,000 as of March 31, 2014 and December 31, 2013, respectively.

NOTE 6 NOTES PAYABLE AND CAPITAL LEASES:

At March 31, 2014 and December 31, 2013, the Company had notes payable and capital leases comprised of the following (in thousands):

	March 31, 2014	December 31, 2013
Notes payable:		
Capital One lines of credit (NSBF)		
Guaranteed line	$ 15,881	$ 21,261
Unguaranteed line	5,872	4,691
Summit Partners Credit Advisors, L.P. (NBS)	8,740	8,650
Sterling National bank line of credit (NBC)	6,248	6,026
Capital One term loan (NTS)	486	590
Total notes payable	37,227	41,218
Note payable securitization trust DS)	57,786	60,140
Total notes payable	$ 95,013	$ 101,358
Capital lease obligation	$ 585	$ 642

NOTE 7 STOCK OPTIONS AND RESTRICTED SHARES:

The Company had three share-based compensation plans as of March 31, 2014 and 2013. For the three months ended March 31, 2014 and 2013, share-based compensation expense for those plans was $158,000 and $166,000, respectively, of which $115,000 and $136,000 are included in salaries and benefits, and $43,000 and $30,000 are included in other general and administrative costs for the three months ended March 31, 2014 and 2013, respectively. During the three months ended March 31, 2014, approximately 69,500 shares awarded under the plans were forfeited due to early termination or resignation by certain employees. The total forfeiture credit recognized for the three months ended March 31, 2014 was approximately $66,000 and is included in share-based compensation expense.

During the third quarter of 2013, the Company granted certain employees an aggregate of 70,000 restricted shares of common stock valued at $176,000 with 10,000 vesting on March 1, 2016 and 60,000 vesting on July 31, 2016. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee s employment. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the shares vest. The Company recorded $13,000 to share-based compensation for the three months ended March 31, 2014 in connection with the vesting period associated with grants that remain outstanding.

During the second quarter of 2013, the Company granted certain employees and executives an aggregate of 80,000 restricted shares of common stock valued at $174,000 with a vesting date of March 1, 2016. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee s employment. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the shares vest. The Company recorded $2,000 to share-based compensation for the three months ended March 31, 2014 in connection with the vesting period associated with grants that remain outstanding.

Table of Contents

During the first quarter of 2013, the Company granted certain employees, executives and directors an aggregate of 300,000 restricted shares of common stock valued at $556,000. The employee and executive grants have a vesting date of March 1, 2016 while the directors vest July 1, 2015. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee s employment. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the shares vest. The Company recorded $47,000 to share-based compensation for the three months ended March 31, 2014 in connection with the vesting period associated with grants that remain outstanding.

In the second quarter of 2012, Newtek granted certain employees and executives an aggregate of 123,000 restricted shares valued at $184,000. The grants vest on July 1, 2014. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the shares vest. The Company recorded $13,000 to share-based compensation for the three months ended March 31, 2014 in connection with the vesting period associated with grants that remain outstanding.

In March 2011, Newtek granted certain employees, executives and board of directors an aggregate of 1,142,000 shares of restricted stock valued at $1,941,000 or $1.70 per share. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the shares vest. The grants are valued using the straight-line method and vest on July 1, 2014. The Company recorded $87,000 to share-based compensation for the three months ended March 31, 2014 in connection with the vesting period associated with grants that remain outstanding.

NOTE 8 INCOME PER SHARE:

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

The calculations of income per share were:

(In thousands except per share data):	**Three months ended March 31: 2014**	**2013**
Numerator for basic and diluted EPS income available to common shareholders	$ 1,391	$ 1,452
Denominator for basic EPS weighted average shares	35,432	35,218
Effect of dilutive securities	2,954	2,518
Denominator for diluted EPS weighted average shares	38,386	37,736

Earnings per share: Basic and Diluted	$ 0.04	$ 0.04
The amount of anti-dilutive shares/units excluded from above is as follows:		
Stock options and restricted shares		
Warrants		50
Contingently issuable shares	83	83

NOTE 9 COMMITMENTS AND CONTINGENCIES:

In the ordinary course of business and from time to time, we are named as a defendant in various legal proceedings. The Company evaluates such matters on a case by case basis and its policy is to contest vigorously any claims it believes are without compelling merit.

We recognize a liability for a contingency in accrued expenses and other liabilities when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. If the reasonable estimate of a probable loss is a range, we accrue the most likely amount of such loss, and if such amount is not determinable, then we accrue the minimum in the range as the loss accrual. The determination of the outcome and loss estimates requires significant judgment on the part of management.

The Company is currently involved in various contract claims and litigation matters. In addition, and as fully described in Item 1. Legal Proceedings, during the quarter ended June 30, 2013 the Federal Trade Commission amended an existing complaint in the matter Federal Trade Commission v. WV Universal Management, LLC et al. to include Universal Processing Services of Wisconsin, LLC (UPS), the Company s merchant processing subsidiary, as an additional defendant on one count. The Company does not believe that the facts or the FTC s legal theory support the FTC s allegations against UPS as set forth in the complaint, and the Company intends to vigorously challenge the FTC s claims. As such, we have not established a loss contingency for this matter.

In May 2013, Data Processing Service of Georgia, Inc. (DPS) , the automated clearing house provider used by the Company s payroll processing subsidiary, PMT Payroll, LLC (PMT), ceased processing payments which resulted in the inability or refusal of DPS s processing bank, Bancorp Bank (Bancorp), to send the corresponding credits to PMT s customers employees. The total amount debited from PMT s customer accounts and unsuccessfully credited to its customers employees was approximately $1,318,000. Upon learning of this failure, PMT and the Company immediately paid all funds owing directly to any of its affected customers employees. Of this amount, the Company has successfully recovered approximately $800,000 to date. On June 22, 2013, Bancorp filed an Interpleader Complaint in the United States District Court for the District of Delaware (the Court) and deposited with the Court $247,925.36, the balance remaining in the DPS settlement account maintained at Bancorp. Bancorp named as defendants PMT and the other payroll companies, and their clients, who Bancorp has alleged may have claims to the funds on deposit with the Court. On October 22, 2013, Bancorp Bank filed its Amended Interpleader Complaint. On December 20, 2013, PMT answered the Amended Interpleader Complaint and asserted cross-claims against DPS for breach of contract and conversion and counterclaims against Bancorp for aiding and abetting DPS s wrongful conduct. The Company is vigorously pursuing its claims against Bancorp and DPS, and believes it is reasonably possible a loss may occur if the Company is unsuccessful in the action. While such a loss is possible, the Company does not believe that it is probable or that the amount can be estimated at this time.

On January 21, 2014, NCMIC Finance Corporation (NCMIC) filed a complaint against Universal Processing Services of Wisconsin, LLC (UPS), the Company s merchant processing subsidiary, in the United States District Court for the Southern District of Iowa. The Complaint asserts claims against UPS for breach of the UPS and NCMIC agreement for the processing of credit card transactions, and seeks monetary relief. The Company believes that the claims asserted in the complaint are wholly without merit and intends to vigorously defend the action.

Management has determined that, in the aggregate, the pending legal actions should not have a material adverse effect on our consolidated results of operations, cash flows or financial condition. In addition, we believe that any amount that could be reasonably estimated of potential loss or range of potential loss is not material.

NOTE 10 SEGMENT REPORTING:

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

The Electronic payment processing segment is a processor of credit card transactions, as well as a marketer of credit card and check approval services to the small- and medium-sized business market. Expenses include direct costs (included in a separate line captioned electronic payment processing costs), salaries and benefits, and other general and administrative costs all of which are included in the respective caption on the condensed consolidated statements of income.

The Small business finance segment consists of Small Business Lending, Inc., a lender that primarily originates, sells and services government guaranteed SBA 7(a) loans to qualifying small businesses through NSBF, its licensed SBA lender; the Texas Whitestone Group which manages the Company s Texas Capco; and NBC which provides accounts receivable financing, billing and accounts receivable maintenance services to businesses. NSBF generates revenues from sales of loans, servicing income for those loans retained or contracted to service by NSBF and interest income earned on the loans themselves. The lender generates expenses for interest, salaries and benefits, depreciation and amortization, and provision for loan losses, all of which are included in the respective caption on the condensed consolidated statements of income. NSBF also has expenses such as loan recovery expenses, loan processing costs, professional fees, and other expenses that are all included in the other general and administrative costs caption on the condensed consolidated statements of income.

The Managed technology solutions segment consists of NTS, acquired in July 2004. NTS s revenues are derived primarily from web hosting services and consist of web hosting and set up fees. NTS generates expenses such as salaries and benefits, and depreciation and amortization, which are included in the respective caption on the accompanying condensed consolidated statements of income, as well as professional fees, licenses and fees, rent, and general office expenses, all of which are included in other general and administrative costs in the respective caption on the condensed consolidated statements of income.

The All other segment includes revenues and expenses primarily from qualified businesses that received investments made through the Company s Capcos which cannot be aggregated with other operating segments. The two largest entities in the segment are Newtek Insurance Agency, LLC, an insurance sales operation, and Business Connect, LLC, a provider of sales and processing services. Also included in this segment are: Newtek Payroll Services, a provider of payroll management, payment and tax reporting services, Exponential of New York, LLC, and Advanced Cyber Security Systems, LLC, (ACS), a start-up company formed to offer web-based security solutions to the marketplace.

Table of Contents

Corporate activities represent revenue and expenses not allocated to our segments. Revenue includes interest income and management fees earned from Capcos (and included in expenses in the Capco segment). Expenses primarily include corporate operations related to broad-based sales and marketing, legal, finance, information technology, corporate development and additional costs associated with administering the Capcos.

The Capco segment, which consists of the twelve Capcos, generates non-cash income from tax credits, interest income and gains from investments in qualified businesses which are included in other income. Expenses primarily include non-cash interest and insurance expense, management fees paid to Newtek (and included in the Corporate activities revenues), legal, and auditing fees and losses from investments in qualified businesses.

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

- the nature of the product and services;
- the type or class of customer for their products and services;
- the methods used to distribute their products or provide their services; and
- the nature of the regulatory environment (for example, banking, insurance, or public utilities).

Table of Contents

The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

The following table presents the Company s segment information for the periods ended March 31, 2014 and 2013 and total assets as of March 31, 2014 and December 31, 2013 (in thousands):

	For the three months ended March 31, 2014	For the three months ended March 31, 2013
Third Party Revenue		
Electronic payment processing	$ 21,528	$ 21,679
Small business finance	10,038	7,449
Managed technology solutions	4,056	4,394
All other	576	646
Corporate activities	199	200
Capcos	104	50
Total reportable segments	36,501	34,418
Eliminations	(414)	(274)
Consolidated Total	$ 36,087	$ 34,144
Inter-Segment Revenue		
Electronic payment processing	$ 907	$ 724
Small business finance	155	126
Managed technology solutions	145	147
All other	428	446
Corporate activities	1,001	1,004
Capcos	190	204
Total reportable segments	2,826	2,651
Eliminations	(2,826)	(2,651)
Consolidated Total	$	$
Income (loss) before income taxes		
Electronic payment processing	$ 1,718	$ 1,835
Small business finance	2,691	2,175
Managed technology solutions	751	896
All other	(399)	(462)
Corporate activities	(2,187)	(1,956)
Capcos	(271)	(286)

Total reportable segments	2,303	2,202
Eliminations	(87)	( )
Totals	$ 2,216	$ 2,202
Depreciation and amortization		
Electronic payment processing	$ 61	$ 113
Small business finance	369	271
Managed technology solutions	337	326
All other	51	51
Corporate activities	37	45
Capcos		1
Totals	$ 855	$ 807

26

Table of Contents

Identifiable assets	As of March 31, 2014	As of December 31, 2013
Electronic payment processing	$ 8,697	$ 9,060
Small business finance	152,324	156,444
Managed technology solutions	12,234	12,027
All other	3,733	3,828
Corporate activities	8,156	9,357
Capco	7,304	7,896
Consolidated Total	$ 192,448	$ 198,612

Table of Contents

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

Introduction and Certain Cautionary Statements

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

The statements in this Quarterly Report on Form 10-Q 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 in its operating business projects and their impact on revenues and profit margins or additional factors as described in the Company s Annual Report on Form 10-K.

Our Capcos operate under a different set of rules in each of the six jurisdictions which 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.

Executive Overview

For the quarter ended March 31, 2014, the Company reported income before income taxes of $2,216,000, which was essentially unchanged from the $2,202,000 reported for the same quarter of 2013. Net income decreased by $61,000 to $1,391,000 in the first quarter of 2014 from $1,452,000 in the year ago quarter. Total revenues increased by $1,943,000 to $36,087,000 from $34,144,000 for the quarter ended March 31, 2014 compared with the same period in 2013, due primarily to the increased revenues in the Small business finance segment.

In Electronic payment processing, the segment had a decrease in revenue primarily due to a reduction in the average number of merchants, as well as a reduction in the average dollar volume per transaction. EPP margin also decreased from 15.7% to 14.8% due in part to competitive pricing as well as a reduction in the mix of merchant sales volumes recorded in the current quarter. Net income before taxes decreased by 6% to $1,718,000 for the three months ended March 31, 2014 compared with the year ago quarter.

In the Small business finance segment, the SBA lender expanded its total volume of loan originations growing the total amount funded by $10,854,000, a 31% increase over the year ago period, and the aggregate servicing portfolio increased by 96% compared with the year ago period. In the current quarter, our external servicing portfolio increased by 227% to $547,279,000, and the NSBF originated portfolio increased by 38% to $521,460,000, bringing our aggregate portfolio to over $1 billion at March 31, 2014. Total servicing fee income increased by 80% and totaled $2,625,000 for the three months ended March 31, 2014. Interest income also increased by $550,000 as a result of the average outstanding performing portfolio of SBA loans held for investment, which increased by $34,518,000 over the same quarter of 2013. Overall, the lending segment reported $2,691,000 in income before taxes for the first quarter of 2014, a 24% increase compared with the three months ended March 31, 2013.

Managed technology solutions segment revenue decreased by 8% to $4,056,000 for the three months ended March 31, 2014, a $338,000 decrease in web hosting and web design revenue compared with the same quarter in 2013. Total expenses decreased by 6% primarily in other general and administrative costs, resulting in a $145,000 decrease in income before taxes between quarters.

In the All other segment, total revenue decreased by 11% for the quarter ended March 31, 2014 compared with the same period in 2013, due primarily to a decrease in insurance commission revenue. Reductions in salaries and benefits, as well as other general and administrative costs in this segment offset the decrease in revenue and resulted in a $63,000 improvement in loss before income taxes for the quarter over quarter period. The loss before income taxes in the Corporate segment increased by 12% to $2,187,000, due primarily to an increase in marketing expense in connection with the Company s television ad campaign, and the loss in the Capco segment had a modest improvement decreasing by 5% to $271,000 for the three months ended March 31, 2014.

On October 1, 2013, the company filed a Form N-2 Registration Statement with the Securities and Exchange Commission. The Company s intention is to file an election to be regulated as a Business Development Company (BDC) under the Investment Company Act of 1940 prior to the completion of an offering, and intends to operate subsequently as an internally managed, non-diversified closed-end investment company. The Company also intends to elect to be treated as a Regulated Investment Company

Table of Contents

(RIC) under Subchapter M of the Internal Revenue Code (the Code) for U.S. federal income tax purposes. We intend to use the net proceeds of the offering primarily to expand our small to medium-sized business, (SMB) lending, make direct investments in portfolio companies in accordance with our investment objectives and strategies described in the prospectus, and for general corporate purposes. We believe that transitioning to a BDC and RIC will provide us with access to lower-cost capital and a business structure conducive to expanding our lending activities and will assist in maximizing our value to shareholders by, among other things, permitting us to value our assets and controlled portfolio companies at fair value. As a BDC, we will seek to generate both current income and capital appreciation primarily through loans originated by our small business finance platform and our equity investments in certain portfolio companies that we control. While our primary investment focus as a BDC will continue to be making loans and providing business services to the SMB market through our controlled portfolio companies, we may also make opportunistic investments in larger or smaller companies. We expect to continue to grow our business organically, both directly and through our controlled portfolio companies, as we have historically. The Company has filed amendments to the Registration Statement, and the related Proxy-Prospectus on Form N-14, in response to comments received from staff of the SEC and is continuing to pursue this course of action.

Table of Contents

Business Segment Results:

The results of the Company s reportable segments for the three months ended March 31, 2014 and 2013 are discussed below:

Electronic Payment Processing

(In thousands):	Three months ended March 31: 2014	2013	$ Change	% Change
Revenue:				
Electronic payment processing	$ 21,528	$ 21,677	$ (149)	(1)%
Interest income		2	(2)	(100)%
Total revenue	21,528	21,679	(151)	(1)%
Expenses:				
Electronic payment processing costs	18,350	18,272	78	%
Salaries and benefits	937	982	(45)	(5)%
Professional fees	116	147	(31)	(21)%
Depreciation and amortization	61	113	(52)	(46)%
Insurance expense related party	12	12		%
Other general and administrative costs	334	318	16	5%
Total expenses	19,810	19,844	(34)	%