

NewStar Financial, Inc.  
Form 10-Q  
November 03, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2017

OR

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

For the transition period from                      to

Commission File Number: 001-33211

NewStar Financial, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware  
( State or other jurisdiction of

54-2157878

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

incorporation or organization) (I.R.S. Employer  
Identification No.)

500 Boylston Street, Suite 1250,

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

Registrant's telephone number, including area code: (617) 848-2500

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a small reporting company) Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of November 1, 2017, the registrant had 41,555,754 shares of common stock, \$0.01 par value per share, outstanding.



TABLE OF CONTENTS

	Page
PART I	
FINANCIAL INFORMATION	
Item 1. <u>Financial Statements (Unaudited)</u>	5
<u>Condensed Consolidated Balance Sheets as of September 30, 2017 and December 31, 2016</u>	5
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2017 and 2016</u>	6
<u>Condensed Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2017 and 2016</u>	7
<u>Condensed Consolidated Statements of Changes in Stockholders' Equity for the Nine Months Ended September 30, 2017 and 2016</u>	8
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2017 and 2016</u>	9
<u>Notes to Condensed Consolidated Financial Statements</u>	11
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	49
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	71
Item 4. <u>Controls and Procedures</u>	72
PART II	
OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	73
Item 1A. <u>Risk Factors</u>	73
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	74
Item 6. <u>Exhibits</u>	75
<u>SIGNATURES</u>	77

Note Regarding Forward Looking Statements

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

- our anticipated financial condition, including estimated loan losses;
- our expected results of operation;
- our growth and market opportunities;
- trends and conditions in the financial markets in which we operate;
- our future funding needs and sources and availability of funding;
- our involvement in capital-raising transactions;
- our ability to meet draw requests under commitments to borrowers under certain conditions;
- our competitors;
- our provision for credit losses;
- our future development of our products and markets;
- our ability to compete;
- our stock price or dividend policy; and
- the consummation of the transactions contemplated by our definitive merger agreement with First Eagle Holdings, Inc. (First Eagle) and our asset purchase agreement with GSO Diamond Portfolio Holdco LLC (GSO), each of which is described in more detail in this Quarterly Report.

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

- risk of deterioration in credit quality that could result in levels of delinquent or non-accrual loans that would force us to realize credit losses exceeding our allowance for credit losses and deplete our cash position;
- risks and uncertainties relating to the financial markets generally, including disruptions in the global financial markets;
- uncertainties relating to the market price of our common stock prevailing from time to time;
  - risk and uncertainties related to our ability to obtain external financing;
- risk and uncertainties relating to the regulation of the commercial lending industry by federal, state and local governments;
- our ability to minimize losses, achieve profitability, and realize our deferred tax asset;
  - the competitive nature of the commercial lending industry and our ability to effectively compete;
- the failure to obtain the approval of the Company’s stockholders or required regulatory approvals or the failure to satisfy any other closing conditions to the Merger Agreement or the Asset Purchase Agreement as defined and described under Note 17 in this Quarterly Report;
- the occurrence of any event, change or other circumstance that could give rise to the termination of the Merger Agreement or Asset Purchase Agreement; and
- potential disruption of management’s attention from our ongoing business operations due to the transactions contemplated by the Merger Agreement and Asset Purchase Agreement, the effect of the announcement of these transactions and the effect of the operating restrictions in the transaction agreements on the ongoing operations of the Company and its relationship with its investors, funding sources, borrowers and others with whom it does business.



For a further description of these and other risks and uncertainties, we encourage you to carefully read section Item 1A. "Risk Factors" of our Annual Report on Form 10-K, for the year ended December 31, 2016, as supplemented by the risks outline under Part II, Item 1A of this Quarterly Report on Form 10-Q.

The forward-looking statements contained in this Quarterly Report on Form 10-Q speak only as of the date of this report. We expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement contained in this Quarterly Report to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any forward-looking statement is based, except as may be required by law. Statements relating to past dividends or our current dividend policy should not be construed as a guarantee that any future dividends will be paid.

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

## NEWSTAR FINANCIAL, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited

	September 30, 2017	December 31, 2016
	(\$ in thousands, except per share	
	and par value amounts)	
<b>Assets:</b>		
Cash and cash equivalents	\$62,538	\$ 154,480
Restricted cash	251,653	262,643
Cash collateral on deposit with custodians	7,564	7,564
Investments in debt securities, available-for-sale	175,837	119,307
Loans held-for-sale, net	371,941	144,060
Loans, net (including loans at fair value of \$407,465 and \$403,745, respectively)	2,995,997	3,239,191
Interest receivable	15,496	14,622
Property and equipment, net	212	274
Deferred income taxes, net	32,081	40,807
Income tax receivable	6,606	—
Goodwill	17,884	17,884
Identified intangible asset, net	5,318	572
Other assets	59,507	39,188
<b>Total assets</b>	<b>\$4,002,634</b>	<b>\$ 4,040,592</b>
<b>Liabilities:</b>		
Credit facilities, net	\$456,961	\$ 445,493
Term debt, net	16,973	—
Term debt securitizations, net	2,085,733	2,195,064
Senior notes, net	375,287	373,919
Subordinated notes, net	246,929	241,390
Repurchase agreements, net	80,569	55,046
Accrued interest payable	34,435	21,319
Income tax payable	—	12,562
Other liabilities	59,995	48,377
<b>Total liabilities</b>	<b>3,356,882</b>	<b>3,393,170</b>
<b>Stockholders' equity:</b>		
Preferred stock, par value \$0.01 per share (5,000,000 shares authorized);	—	—

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

no shares outstanding)

Common stock, par value \$0.01 per share:		
Shares authorized: 145,000,000 in 2017 and 2016;		
Shares outstanding 41,480,754 in 2017 and 42,820,198 in 2016	415	428
Additional paid-in capital	747,438	743,783
Retained earnings	67,173	59,577
Common stock held in treasury, at cost; 16,182,143 in 2017 and 14,352,904 in 2016	(171,288 )	(152,720 )
Accumulated other comprehensive income (loss), net	2,014	(3,646 )
Total stockholders' equity	645,752	647,422
Total liabilities and stockholders' equity	\$4,002,634	\$ 4,040,592

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

5

---

## NEWSTAR FINANCIAL, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

Unaudited

	Three Months		Nine Months Ended	
	Ended September 30, 2017	2016	September 30, 2017	2016
	(\$ in thousands, except per share amounts)			
<b>Net interest income:</b>				
Interest income	\$58,752	\$65,155	\$170,747	\$186,499
Interest expense	43,145	39,897	126,144	117,816
Net interest income	15,607	25,258	44,603	68,683
Provision for credit losses	1,494	3,570	10,341	24,906
Net interest income after provision for credit losses	14,113	21,688	34,262	43,777
<b>Non-interest income:</b>				
Asset management income	3,544	3,353	11,017	10,337
Fee income	1,025	2,946	6,379	5,836
Realized loss on derivatives, net	—	(13 )	—	(31 )
Realized gain (loss) on sale of loans, net	294	(19 )	1,501	36
Other miscellaneous income, net	1,984	794	5,330	3,490
Mark to market adjustment on fair value loans	(867 )	3,437	(6,817 )	3,705
Loss on total return swap	—	—	—	(6,062 )
Unrealized (loss) gain on loans held-for-sale, net	(457 )	468	(557 )	(5,345 )
Gain on sale of Business Credit, net	—	—	—	22,511
Total non-interest income	5,523	10,966	16,853	34,477
<b>Operating expenses:</b>				
Compensation and benefits	7,480	13,175	21,664	32,640
General and administrative expenses	4,420	4,894	12,172	15,337
Total operating expenses	11,900	18,069	33,836	47,977
Income before income taxes	7,736	14,585	17,279	30,277
Income tax expense	3,151	5,941	7,160	12,383
Net income	\$4,585	\$8,644	\$10,119	\$17,894
Basic Earnings per share	\$0.11	\$0.19	\$0.24	\$0.38
Diluted Earnings per share	\$0.11	\$0.19	\$0.24	\$0.38
Dividends declared per common share	\$0.02	\$—	\$0.06	\$—

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

NEWSTAR FINANCIAL, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Unaudited

	Three Months Ended September 30, 2017 2016		Nine Months Ended September 30, 2017 2016	
	(\$ in thousands, except per share amounts)			
Net income	\$4,585	\$8,644	\$10,119	\$17,894
Other comprehensive income (loss), net of tax:				
Net unrealized securities gains (losses), net of tax expense				
(benefit) of \$604, \$2,044, \$3,871 and \$789, respectively	884	3,028	5,664	1,193
Net unrealized derivative gains, net of tax expense				
(benefit) of \$[-], \$5, \$(3) and \$2, respectively	—	8	(4)	(3)
Other comprehensive income (loss)	884	3,036	5,660	1,190
Comprehensive income	\$5,469	\$11,680	\$15,779	\$19,084

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

7

NEWSTAR FINANCIAL, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Unaudited

## NewStar Financial, Inc. Stockholders' Equity

For the Nine Months Ended September 30, 2017

	Additional		Retained Earnings	Treasury Stock	Accumulated	Common Stockholders' Equity
	Common Stock	Paid-in Capital			Other Comprehensive Loss, net	
	(\$ in thousands)					
Balance at January 1, 2017	\$428	\$743,783	\$59,577	\$(152,720)	\$ (3,646 )	\$ 647,422
Net income	—	—	10,119	—	—	10,119
Other comprehensive income	—	—	—	—	5,660	5,660
Common stock dividends of \$0.06 per share	—	—	(2,523 )	—	—	(2,523 )
Issuance of restricted stock	4	(4 )	—	—	—	—
Net shares reacquired from employee transactions	(1 )	1	—	(829 )	—	(829 )
Repurchase of common stock	(18 )	18	—	(17,739 )	—	(17,739 )
Exercise of common stock options, net	2	1,039	—	—	—	1,041
Amortization of restricted common stock awards	—	2,601	—	—	—	2,601
Balance at September 30, 2017	\$415	\$747,438	\$67,173	\$(171,288)	\$ 2,014	\$ 645,752

## NewStar Financial, Inc. Stockholders' Equity

For the Nine Months Ended September 30, 2016

	Additional		Retained Earnings	Treasury Stock	Accumulated	Common Stockholders' Equity
	Common Stock	Paid-in Capital			Other Comprehensive Income, net	
	(\$ in thousands)					
Balance at January 1, 2016	\$465	\$742,970	\$31,353	\$(109,245)	\$ (6,065 )	\$ 659,478
Net income	—	—	17,894	—	—	17,894
Other comprehensive income	—	—	—	—	1,190	1,190
Issuance of restricted stock	6	(6 )	—	—	—	—
Net Shares reacquired from employee transactions	(1 )	1	—	(445 )	—	(445 )
	—	(473 )	—	—	—	(473 )

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

Tax benefit (expense) from vesting of restricted stock

Repurchase of common stock	(12 )	12	—	(8,862 )	—	(8,862 )
Exercise of common stock options, net	9	(1,108 )	—	—	—	(1,099 )
Tax benefit from exercise of stock options	—	1,225	—	—	—	1,225
Amortization of restricted common stock awards	—	2,822	—	—	—	2,822
Balance at September 30, 2016	\$467	\$745,443	\$49,247	\$(118,552)	\$ (4,875 )	\$ 671,730

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

8

---

## NEWSTAR FINANCIAL, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

	Nine Months Ended September 30,	
	2017	2016
	(\$ in thousands)	
<b>Cash flows from operating activities:</b>		
Net income	\$10,119	\$17,894
<b>Adjustments to reconcile net income to net cash used for operations:</b>		
Provision for credit losses	10,341	24,906
Depreciation, amortization and accretion, net	(9,609 )	(9,159 )
Amortization of debt issuance costs	12,818	13,720
Equity compensation expense	2,601	2,822
Gain on sale of Business Credit, net	—	(22,511 )
Gain on sale of loans, net	(1,501 )	(36 )
Loss on total return swap	—	6,062
Gain on sale of equipment, net	—	(724 )
Loss on sale of CLO bonds	2	—
Net change in deferred income taxes	4,859	2,466
Loans held-for-sale originated	(765,180)	(217,132 )
Proceeds from sale of loans held-for-sale	568,288	313,287
Unrealized loss on loans held-for-sale, net	557	5,345
Net change in interest receivable	(874 )	(2,340 )
Net change in other assets	(17,406 )	(15,090 )
Net change in accrued interest payable	13,116	13,086
Net change in other liabilities	(32,505 )	(11,165 )
Net cash (used in) provided by operating activities	(204,374)	121,431
<b>Cash flows from investing activities:</b>		
Net change in restricted cash	10,991	(240,397 )
Net change in loans and leases	233,681	(92,685 )
Purchase of equity investments	(5,222 )	(4,052 )
Return of capital - equity investments	793	—
Purchase of debt securities, available-for-sale	(39,709 )	—
Proceeds from debt securities, available-for-sale	6,226	6,000
Purchase of property and equipment	(20 )	(9 )
Net cash provided by (used in) investing activities	206,740	(331,143 )
<b>Cash flows from financing activities:</b>		
Inputs from exercise of stock options, net	1,041	(1,099 )
Tax benefit from exercise of stock options	—	1,225
Tax expense from vesting of restricted stock	—	(473 )
Payment of dividends on common stock	(2,523 )	—
Advances on credit facilities	431,100	1,282,522
Repayment of borrowings on credit facilities	(421,500)	(1,602,978)
Issuance of term debt securitization	303,000	623,197
Borrowings on term debt securitization	—	37,600

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

Repayment of borrowings on term debt securitization	(415,057)	(142,155 )
Borrowing of term debt	4,000	—
Borrowing on subordinated notes	—	24,500
Borrowings on repurchase agreements	29,539	3,496
Repayment of borrowings on repurchase agreements	(4,016 )	(47,694 )
Release of cash collateral	—	53,517
Payment of deferred financing costs	(1,324 )	(10,240 )
Purchase of treasury stock	(18,568 )	(9,307 )
Net cash (used in) provided by financing activities	(94,308 )	212,111
Net decrease in cash during the period	(91,942 )	2,399
Cash and cash equivalents at beginning of period	154,480	35,933
Less cash of Equipment Finance held-for-sale	—	(2,066 )
Cash and cash equivalents at end of period	\$62,538	\$36,266

9

NEWSTAR FINANCIAL, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS, continued

Unaudited

	Nine Months Ended September 30,	
	2017	2016
	(\$ in thousands)	
Supplemental cash flows information:		
Interest paid	\$113,078	\$104,731
Taxes paid, net of refund	21,478	5,201
Assumed debt related to acquisition of investment in available for sale securities	12,973	—
Transfer of loans, net to other real estate owned	—	15,781
Transfer of loans, net to loans-held-for-sale, at fair value	31,546	67,704
Transfer of Equipment Finance assets to held-for-sale	—	160,735
Transfer of Equipment Finance liabilities to held-for-sale	—	44,158
Unsettled trades payable	21,488	138,639

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

NEWSTAR FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

Note 1. Organization

NewStar Financial, Inc. ("NewStar"), together with its consolidated subsidiaries (collectively, the "Company"), is an internally-managed, middle market direct lender and credit-oriented asset manager headquartered in Boston, MA. The Company's direct lending activities are focused on meeting the complex financing needs of companies and private investors in the middle market by offering a range of flexible debt financing options. The Company also offers a range of investment management products employing credit-oriented strategies focused on middle market loans and liquid, tradeable credit. The Company manages approximately \$7.2 billion of assets, \$3.6 billion held in consolidated subsidiaries of the Company and \$3.6 billion in off balance sheet credit funds.

NewStar operates its business through two reportable segments: Commercial Lending and Asset Management.

Commercial Lending

These lending activities require specialized skills and transaction experience, as well as a significant investment in personnel and operating infrastructure. To meet these demands, our loans are originated directly by teams of credit-trained bankers. These teams are supported by centralized credit management and operating platforms. This structure enables us to leverage common standards, systems, and industry and professional expertise across the two segments.

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

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

The size of financing commitments depends on various factors, including the type of loan, the credit characteristics of the borrower, the economic characteristics of the loan, and the Company's role in the transaction. The Company also arranges larger transactions that it may retain on its balance sheet or syndicate to other lenders, which include off balance sheet managed credit funds managed by the Company for third party institutional investors. By syndicating loans to other lenders and the Company's off balance sheet managed credit funds, it is able to provide larger financing commitments to its customers and generate fee income, while limiting its risk exposure to single borrowers.

#### Asset Management

As a registered investment adviser, NewStar offers a range of investment products employing credit-oriented strategies focused on middle market loans and liquid tradeable credit. The Company manages a series of private credit funds that co-invest in middle market loans originated through its established leveraged finance lending platform. Through its registered investment adviser subsidiary, NewStar Capital, the Company also manages assets across a series of CLOs that invest primarily in broadly syndicated loans, as well as other sponsored funds and managed accounts that invest across various liquid, non-investment grade asset classes, including broadly syndicated loans and bonds.

#### Note 2. Summary of Significant Accounting Policies

##### Basis of Presentation

These interim condensed consolidated financial statements include the accounts of the Company and its subsidiaries and those variable interest entities ("VIEs") where the Company is the primary beneficiary. These interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X.

Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. All significant intercompany transactions have been eliminated in consolidation. In the opinion of Management, all adjustments (consisting of normal recurring adjustments) considered necessary for the fair presentation of the interim condensed consolidated financial statements have been included. These interim condensed financial statements may not be indicative of financial results for the full year. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosure of contingent assets and liabilities. Actual results could differ from those estimates. The estimates most susceptible to change in the near-term are the Company's estimates of its (i) allowance for credit losses, (ii) recorded amounts of deferred income taxes, (iii) fair value measurements used to record fair value adjustments to certain financial instruments, (iv) valuation of investments, (v) determination of other than temporary impairments and temporary impairments and (vi) impairment of goodwill and identified intangible assets. The interim condensed consolidated financial statements and notes thereto should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

As discussed in Note 17, the Company entered into a definitive agreement with First Eagle Holdings, Inc. and certain of its direct and indirect subsidiaries, as a result of which the Company will become an indirect wholly-owned subsidiary of First Eagle. The closing of the transactions contemplated by the agreement is subject to the approval of our stockholders, regulatory approvals, and other conditions. As a result, none of the condensed consolidated financial statements and related disclosures in this Form 10-Q consider the potential impact of the pending merger and related transactions.

#### Principles of Consolidation

The Company consolidates entities in which it, directly or indirectly, is determined to have a controlling financial interest under ASC Topic 810, as amended by ASU No. 2015-02, Consolidation – Amendments to the Consolidation Analysis, which revised the existing consolidation guidance and required the Company to re-evaluate whether to consolidate certain types of entities. The Company evaluates (1) whether it holds a variable interest in an entity, (2) whether the entity is a VIE, and (3) whether the Company's involvement would make it the primary beneficiary.

#### Investments in Consolidated Variable Interest Entities

The Company sponsors the formation of various entities that are considered to be VIEs. The majority of these VIEs were formed to issue term debt securitizations used to fund the Company's lending activities. The assets of the VIEs are primarily comprised of senior secured loans and the liabilities are primarily comprised of asset backed securities. In instances where the Company retains 100% of the equity interests and services the loans, the Company is considered the primary beneficiary of the VIE and consolidates the entities.

#### Investments in Unconsolidated Variable Interest Entities and Other Unconsolidated Entities

The Company also holds variable interests in certain VIEs that are not consolidated because the Company is not considered the primary beneficiary, including its investments in certain managed credit funds and CLOs. The Company's involvement with such entities is in the form of equity interests that the Company has deemed more than insignificant and/or asset management fees for services provided. In instances where the Company holds equity interests, those interests are held on our balance sheet and included in Investments in Debt Securities, Available-for-Sale.

The Company manages a series of other entities and separately managed accounts for third parties. The Company receives fees for services performed with respect to such entities, which the Company has determined are not variable interests. These fees earned by the Company are included in asset management income.

Investments in unconsolidated variable interest entities and other unconsolidated entities are referred to in this Quarterly Report as off balance sheet managed credit funds.

#### Prior Period Reclassification

Prior period amounts are reclassified wherever necessary to conform with current period presentation.

#### Recently Adopted Accounting Standards

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740). ASU 2015-17 eliminates the requirement to separate deferred income tax liabilities into current and non-current classification in a classified balance sheet. It further requires that all deferred income taxes be classified as non-current in a classified balance sheet. ASU 2015-17 is effective for annual periods and interim periods within that reporting period beginning after December 15, 2016. The Company adopted ASU 2015-17 on January 1, 2017. The adoption of ASU 2015-17 did not have an impact on its consolidated financial statements as the Company does not classify its deferred income tax liabilities into current and non-current on its Consolidated Balance Sheet.

In March 2016, the FASB issued ASU 2016-07, Simplifying the Transition to the Equity Method of Accounting (Topic 323). ASU 2016-07 eliminates the requirement for an investor to retroactively apply the equity method when its increase in ownership interest (or degree of influence) in an investee triggers equity method accounting. ASU 2016-07 is effective for interim and

annual periods in fiscal years beginning after December 15, 2016. The Company adopted ASU 2016-07 on January 1, 2017. The adoption of ASU 2016-07 did not impact its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting (Topic 718). ASU 2016-09 simplifies several aspects of the accounting for employee share-based payment transactions including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification of related amounts within the statement of cash flows. ASU 2016-09 is effective for annual periods and interim periods within that reporting period beginning after December 15, 2016. The Company adopted ASU 2016-09 on January 1, 2017 and elected to continue to estimate forfeitures. The Company's adoption was prospective, therefore, prior periods have not been adjusted. The adoption of ASU 2016-09 could result in increased volatility to reported income tax expense related to excess tax benefits and tax deficiencies for employee share-based transactions, however, the actual amounts recognized in income tax expense will be dependent on the amount of employee share-based transactions and the stock price at the time of vesting or exercise. For the first quarter of 2017, the adoption of ASU 2016-09 resulted in a decrease to the provision for income taxes, primarily due to the tax benefit from the exercise of stock options and the vesting of restricted stock. The presentation of excess tax benefits in the statement of cash flows shifted to an operating activity from the prior classification as a financing activity.

In December 2016, the FASB issued ASU 2016-19, Technical Corrections and Improvements. ASU 2016-19 includes amendments to provide guidance clarification and references corrections and provide minor structural changes to headings or minor editing to text to improve usefulness and understandability. ASU 2016-19 is effective for annual periods and interim periods within that reporting period beginning after December 31, 2016. The Company adopted ASU 2016-19 as of January 1, 2017. The adoption of ASU 2016-19 did not have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. ASU 2017-01 clarifies the definition of a business to assist with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 is effective for annual periods and interim periods within that reporting period beginning after December 15, 2017, with early adoption permitted. The Company early adopted ASU 2017-01 as a result of the Fifth Street CLO Management LLC acquisition. The adoption of ASU 2017-01 did not have a material impact on its consolidated financial statements.

#### Issued Accounting Standards Not Yet Adopted

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in GAAP when it becomes effective. The standard permits the use of either the retrospective or cumulative effect transition method. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which deferred the effective date of ASU 2014-09 to annual and interim periods beginning after December 15, 2017, while earlier application is permitted only for annual and interim periods beginning after December 31, 2016. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), that clarifies how to apply revenue recognition guidance related to whether an entity is a principal or an agent. The update clarifies that an entity is a principal when it controls the specified good or service before that good or service is transferred to the customer, and is an agent when it does not control the specified good or service before it is transferred to the customer. The effective date and transition of ASU 2016-08 is the same as the effective date and transition of ASU 2014-09. In December 2016, the FASB issued ASU 2016-20, Technical Corrections and Improvements to Topic 606, which provides additional clarification and improvements for the following areas: loan guarantee fees, contract costs-impairment testing, provision for losses on construction-type and production-type contracts, cost capitalization guidance, and disclosure requirements. The effective date and transition of ASU 2016-20 is the same as the effective date and transition of ASU 2014-09. The Company has established a team which continues to evaluate and document

the possible impacts of the standard, including potential changes to the accounting for investment management services performed, and also consider any reporting, tax and operational implications. The Company has not yet finalized its transition method, but does not expect, under either method, the provisions of ASU 2014-09 to result in any material changes to the timing of when revenue is recognized. The Company plans to adopt this standard effective January 1, 2018.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments – Recognition and Measurement of Financial Assets and Financial Liabilities (Topic 825-10). ASU 2016-01 amends existing guidance related to the accounting for certain financial assets and liabilities. These amendments, among other things, require equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income, require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset and eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. ASU 2016-01 is effective for annual periods and interim periods within that reporting period beginning after December 15, 2017, with early adoption permitted. The Company is currently evaluating the impact that the adoption of ASU 2016-01 will have on results from operations and financial position.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 amends existing guidance related to the accounting for leases. These amendments, among other things, require lessees to account for most leases on the balance sheet while recognizing expense on the income statement in a manner similar to existing guidance. For lessors the guidance modifies the classification criteria and the accounting for sales-type and direct finance leases. ASU 2016-02 is effective for annual periods and interim periods within that reporting period beginning after December 15, 2018, with early adoption permitted. ASU 2016-02 mandates a modified retrospective transition method for all entities. The Company has performed a preliminary analysis of ASU 2016-02. The adoption of ASU 2016-02 is expected to impact the balance sheet of the Company, as both the value of the leased office space as well as the current value of future lease liabilities will be recorded, however the evaluation has not yet been completed. The Company plans to adopt this standard effective January 1, 2019.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses (Topic 326). ASU 2016-13 sets forth a “current expected credit loss” (CECL) model which requires the Company to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. ASU 2016-13 requires enhanced disclosures, including qualitative and quantitative requirements, to help understand significant estimates and judgments used in estimating credit losses, as well as provide additional information about the amounts recorded in the financial statements. ASU 2016-13 is effective for annual periods and interim periods within that reporting period beginning after December 15, 2019, with early adoption permitted after annual and interim periods within that reporting period beginning after December 31, 2018. ASU 2016-13 mandates a modified retrospective transition method for all entities. The Company is currently in the scoping and evaluating phase of the adoption of ASU 2016-13.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230). ASU 2016-15 provides guidance on the classification of certain cash receipts and cash payments for presentation in the statement of cash flows. ASU 2016-15 is effective for annual periods and interim periods within that reporting period beginning after December 15, 2017, with early adoption permitted. The Company is currently evaluating the impact that the adoption of ASU 2016-15 will have on results from operations or financial position.

In October 2016, the FASB issued ASU 2016-17, Consolidation (Topic 810), Interest Held Through Related Parties That Are Under Common Control. ASU 2016-17 changes the evaluation of whether a reporting entity is the primary beneficiary of a VIE by changing how a reporting entity that is a single decision maker of a VIE treats indirect interests in the entity held through related parties that are under common control with the reporting entity. ASU 2016-17 is effective for annual periods and interim periods within that reporting period beginning after December 15, 2017, with early adoption permitted. The Company is currently evaluating the potential impact of ASU 2016-17 on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. ASU 2016-18 requires that the statement of cash flows include restricted cash in the beginning and end-of-period total amounts shown on the statement of cash flows and that the statement of cash flows explain changes in restricted cash during the period. ASU 2016-18 is effective for annual periods and interim periods within that reporting period beginning after December 15, 2017, with early adoption permitted. However, adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The Company does not expect the adoption of ASU 2016-18 to have a material impact on its financial statements and expects the impact to be disclosure only.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. ASU 2017-04 simplifies the measurement of goodwill impairment by eliminating Step 2 from the goodwill impairment test. Under ASU 2017-04 an entity should perform its annual or interim goodwill impairment test by comparing the fair value of the reporting unit with its carrying amount, and should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value with the loss

not exceeding the total amount of goodwill allocated to that reporting unit. ASU 2017-04 is effective for annual periods and interim periods within that reporting period beginning after December 15, 2019, with early adoption permitted. The Company is currently evaluating the potential impact of ASU 2017-04 on our consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, Receivables – Nonrefundable Fees and Other Costs (Topic 310): Premium Amortization on Purchased Callable Debt Securities. ASU 2017-08 amends the amortization period for certain purchased callable debt securities held at a premium, shortening such period to the earliest call date. ASU 2017-08 is effective for annual periods and interim periods within that reporting period beginning after December 15, 2018, with early adoption permitted. ASU 2017-08 will be adopted using a modified retrospective approach, with the cumulative effect adjustment recognized to retained earnings as of the beginning of the period of adoption. Entities are also required to provide disclosures about a change in accounting principle in the period of adoption. The Company is currently evaluating the potential impact of ASU 2017-08 on our consolidated financial statements.

Note 3. Acquisition and Disposition Activities

Acquisition of Fifth Street CLO Management LLC

On July 20, 2017, the Company acquired 100% of the limited liability company interests of Fifth Street CLO Management LLC (“FSCM”), a wholly-owned subsidiary of Fifth Street Holdings L.P. The purchase included contracts to manage two off balance sheet middle market CLOs and certain interests in the CLOs which will be held on the balance sheet of NewStar after the acquisition to comply with risk retention requirements. FSCM was subsequently rebranded and now operates as NewStar Commercial Loan Originator II LLC, a wholly-owned subsidiary of the Company. The Company evaluated the transaction under ASU 2017-01 and concluded that it does not meet the definition of a business and therefore is treated as an asset acquisition.

The purchase price was \$16.6 million, net of \$13.1 million of assumed indebtedness. The assets acquired and the liabilities assumed in the acquisition were recorded by the company at their estimated fair values as of the acquisition date.

	Fair Value (\$ in thousands)
<b>Assets Acquired</b>	
Investment in available for sale securities	\$ 23,068
Identified intangible assets	5,394
Other assets	1,221
<b>Total assets acquired</b>	<b>\$ 29,683</b>
<b>Liabilities Assumed</b>	
Accrued expenses	\$ 125
Term Debt	12,973
<b>Total Liabilities Assumed</b>	<b>\$ 13,098</b>
<b>Identified, net assets acquired</b>	<b>\$ 16,585</b>

Fair values of the major categories of assets acquired and liabilities assumed were determined as follows:

The fair value of investments in available for sale securities was determined based upon the value of notes of the CLO’s determined through a third party appraisal. The majority of these notes were retained for European Union (“EU”) risk retention rules.

The fair value of the customer contracts and related customer relationships included in identified intangible assets above, was determined using the excess earnings method under the income approach per ASC 820. Management projected net cash flows of each investment / collateral management agreement acquired to estimate the useful life of the respective contracts. These net after-tax cash flows were discounted to present value as of the acquisition date. The fair value of customer contracts and related customer relationships was estimated at \$5.4 million. The intangible assets are being amortized over their expected economic useful life, which we estimate at 3.5 years.

The fair value of other assets included accrued management fees, prepaid expenses and miscellaneous receivables which the Company believes approximated carrying value.

The fair value of the accrued expenses approximated the carrying value of these accounts.

The fair value of the term debt was recorded at the outstanding amount due to the third party as of the acquisition date which the Company believes approximated carrying value.

Sale of NewStar Equipment Finance assets and related platform

On December 1, 2016, the Company sold the assets of NewStar Equipment Finance (“Equipment Finance”) and related platform to a third party and exited the business. The sale of Equipment Finance assets was the result of the Company’s decision to exit businesses with economic models increasingly challenged by competition from banks and other lenders with access to lower cost funding. The sale resulted in a gain of \$6.7 million, before transaction related costs of \$4.3 million. The net gain was recorded in non-interest income on the consolidated statement of operations. In connection with the sale of the assets of Equipment Finance, the Company established a \$1.4 million contingent liability to cover any potential credit indemnification costs resulting from actual credit losses incurred on the assets sold. As of September 30, 2017, this amount was reduced to \$1.0 million. This liability reflects management’s best estimate of losses, taking into consideration the individual credit quality and borrower activity since origination and the anticipated residual value of the assets sold. As of September 30, 2017, the Company had not been notified or required to pay for any credit losses on the assets sold. The initial indemnification is capped at \$10.0 million of actual credit losses and is reduced to \$8.0 million at December 31, 2017, then further reduced to \$5.0 million at December 31, 2018, \$3.0 million at December 31, 2019 and zero as of December 31, 2020.

Sale of NewStar Business Credit LLC

On March 31, 2016, the Company sold its asset based lending business, NewStar Business Credit LLC (“Business Credit”) to a third party. The sale resulted in a gain of \$22.5 million, before transaction related costs of \$2.5 million. The net gain was recorded in non-interest income on the accompanying consolidated statement of operations.

Note 4. Loans Held-for-Sale, Loans, Leases and Allowance for Credit Losses

As of September 30, 2017 and December 31, 2016, loans held-for-sale consisted of the following:

	September 30, 2017	December 31, 2016
	(\$ in thousands)	
Leveraged Finance	\$376,276	\$ 146,126
Lower cost or market adjustment	(716 )	(160 )
Gross loans held-for-sale	375,560	145,966
Deferred loan fees, net	(3,619 )	(1,906 )
Loans held-for-sale, net	\$371,941	\$ 144,060

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

At September 30, 2017, loans held-for-sale consisted of loans with an aggregate outstanding balance of \$376.3 million that were intended to be sold to off balance sheet managed credit funds. The Company sold loans with an outstanding balance totaling \$48.3 million to entities other than off balance sheet managed credit funds for an aggregate gain of \$0.1 million during the nine months ended September 30, 2017. The Company sold loans with an outstanding balance of \$105.0 million for a net loss of \$0.04 million to entities other than off balance sheet managed credit funds during the nine months ended September 30, 2016.

As of September 30, 2017, and December 31, 2016, loans consisted of the following:

	September 30, 2017	December 31, 2016
	(\$ in thousands)	
Leveraged Finance (1)	\$3,049,574	\$ 3,308,926
Real Estate	10,716	10,624
Gross loans	3,060,290	3,319,550
Deferred loan fees and discount, net	(24,534 )	(29,423 )
Allowance for loan losses	(39,759 )	(50,936 )
Total loans, net	\$2,995,997	\$ 3,239,191

(1)Includes loans at fair value of \$407.5 million and \$403.7 million, respectively.

The Company holds broadly syndicated loans in our fair value portfolio as part of our liquid credit strategy, which by nature tend to experience higher prepayment and refinancing rates compared to our middle market loans. As a result

this portfolio may be more actively managed to optimize performance.

The Company provides commercial loans to customers throughout the United States. The Company's borrowers may be susceptible to economic slowdowns or recessions and, as a result, may have a lower capacity to make scheduled payments of interest or principal on their borrowings during these periods. Although the Company has a diversified loan portfolio, certain events may occur, including, but not limited to, adverse economic conditions and adverse events affecting specific clients, industries or markets, that could adversely affect the ability of borrowers to make timely scheduled principal and interest payments on their loans.

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

The Company utilizes a number of analytical tools for the purpose of estimating probability of default and loss given default for its lending groups. The quantitative models employed by the Company in its Leveraged Finance business utilize Moody's KMV RiskCalc credit risk model in combination with a proprietary qualitative model, which generates a rating that maps to a probability of default estimate. For real estate loans, the Company utilizes a proprietary model that has been developed to capture risk characteristics unique to the lending activities in that line of business. Together, these models produce a suggested obligor risk rating which corresponds to a probability of default and also produces a loss given default. In each case, the probability of default and the loss given default are used to calculate an expected loss for those lending groups. Prior to the sale of the Equipment Finance assets, management used similar models for its Equipment Finance portfolio as its Leveraged Finance group. Prior to the sale of Business Credit, management utilized a proprietary model that produced a rating that corresponded to an expected loss, for the Business Credit portfolio.

Loans which are rated at or better than a specified threshold are typically classified as "Pass", and loans rated worse than that threshold are typically classified as "Criticized", a characterization that may apply to impaired loans, including TDR. As of September 30, 2017, \$106.8 million of the Company's loans were classified as "Criticized," all of which were impaired loans, and \$3.0 billion were classified as "Pass". As of December 31, 2016, \$118.7 million of the Company's loans were classified as "Criticized" all of which were impaired loans, and \$3.2 billion were classified as "Pass".

When the Company determines a loan is impaired, the Company will evaluate the loan individually and, if necessary, establish a specific allowance. The loan will be analyzed and may be placed on non-accrual status. If the asset deteriorates further, the specific allowance may increase, and ultimately may result in a loss and charge-off.

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

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

As of September 30, 2017, the Company had investments, net of charge-offs in impaired loans with a balance of \$153.7 million. Impaired loans with an aggregate outstanding balance of \$85.1 million have been restructured and classified as TDRs. At September 30, 2017, additional funding commitments for TDRs totaled \$4.1 million. As of September 30, 2017, the aggregate carrying value of equity investments in certain of the Company's borrowers in connection with troubled debt restructurings totaled \$10.9 million. Impaired loans with an aggregate outstanding balance of \$103.8 million were also on non-accrual status. These non-accrual loans had a carrying value of \$97.4 million before specific reserves. For impaired loans on non-accrual status, the Company's policy is to reverse the accrued interest previously recognized as interest income subsequent to the last cash receipt in the current year. The recognition of interest income on the loan only resumes when factors indicating doubtful collection no longer exist and the non-accrual loan payment status has been brought current. During the three and nine months ended September 30, 2017, the Company charged off \$8.6 million and \$21.5 million, respectively of non-accruing loan balances. During the three months ended September 30, 2017, the Company placed one new relationship on non-accrual status with an aggregate outstanding balance of \$26.9 million. During the nine months ended September 30, 2017, the Company placed loans with an aggregate outstanding balance of \$35.5 million on

non-accrual status. During the three and nine months ended September 30, 2017, the Company recorded \$3.9 million and \$13.4 million, respectively, of net specific provisions for impaired loans. At September 30, 2017, the Company had a \$11.7 million specific allowance for impaired loans with an aggregate outstanding balance of \$100.1 million. At September 30, 2017, additional funding commitments for impaired loans totaled \$14.1 million. The Company's obligation to fulfill the additional funding commitments on impaired loans is generally contingent on the borrower's compliance with the terms of the credit agreement. If the borrower is not in compliance additional funding commitments may be made at the Company's discretion. As of September 30, 2017, the Company had loans totaling \$36.7 million which were greater than 60 days past due and classified as delinquent of which \$4.0 million were on non-accrual status. Included in the \$11.7 million specific allowance for impaired loans was \$5.1 million related to delinquent loans.

As of December 31, 2016, the Company had investments, net of charge offs in impaired loans with a balance of \$133.4 million. At that date, impaired loans with an aggregate outstanding balance of \$114.8 million had been restructured and classified as TDR. As of December 31, 2016, the aggregate carrying value of equity investments in certain of the Company's borrowers in connection with troubled debt restructurings totaled \$9.9 million. Impaired loans with an aggregate outstanding balance of \$99.2 million were also on non-accrual status. These non-accrual loans had a carrying value of \$92.9 million before specific reserves. During 2016, the Company

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

charged off \$25.7 million of outstanding non-accrual loans. During 2016, the Company placed loans with an aggregate outstanding balance of \$27.1 million on non-accrual status and no loans were returned to performing status. During 2016, the Company recorded \$24.8 million of net specific provisions for impaired loans. At December 31, 2016, the Company had a \$19.8 million specific allowance for impaired loans with an aggregate outstanding balance of \$73.5 million. At December 31, 2016, additional funding commitments for impaired loans totaled \$11.9 million. As of December 31, 2016, loans to two borrowers totaling approximately \$21.1 million were on non-accrual status and were greater than 60 days past due and classified as delinquent by the Company. Included in the \$19.8 million specific allowance for impaired loans was \$7.9 million related to delinquent loans.

A summary of impaired loans is as follows:

	Investment, Net of	Investment, Net of Unamortized	Unpaid
	Charge-offs	Discount/Premium	Principal
	(\$ in thousands)		
September 30, 2017			
Impaired loans	\$ 153,716	\$ 146,742	\$ 179,471
December 31, 2016			
Impaired loans	\$ 133,413	\$ 126,839	\$ 154,879

	Recorded	Recorded	Recorded
	Investment, net, Investment with a with a Related Related Allowance Allowance for for Credit Losses	Investment without a Related Allowance for Credit Losses	Investment, net, without a Related Allowance for Credit Losses
	(\$ in thousands)		
September 30, 2017			
Impaired loans	\$ 100,085	\$ 93,176	\$ 53,631
December 31, 2016			
Impaired loans	\$ 73,499	\$ 68,924	\$ 59,914

During the three and nine months ended September 30, 2017, the Company recorded net partial charge-offs of \$8.6 million and \$21.5 million, respectively. During the three months ended September 30, 2016, the Company recorded a net recovery of \$0.05 million on loans previously charged-off, and during the nine months ended September 30, 2016, the Company recorded net charge-offs of \$14.2 million.

When a loan is determined to be uncollectible, the specific allowance is charged off, which reduces the gross investment in the loan. The Company may record the initial specific allowance related to an impaired loan in the same period as it records a partial charge-off in certain circumstances such as if the terms of a restructured loan are finalized during that period.

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

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

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

September 30, 2017	Leveraged Finance		Real Estate	
	Investment	Allowance	Investment	Allowance
	(\$ in thousands)			
Collectively evaluated (1)(2)	\$2,488,393	\$ 28,001	\$10,716	\$ 93
Individually evaluated (3)	153,716	11,665	—	—
Total	\$2,642,109	\$ 39,666	\$10,716	\$ 93

18

---

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

December 31, 2016	Leveraged Finance		Real Estate	
	Investment	Allowance	Investment	Allowance
	(\$ in thousands)			
Collectively evaluated (1)(2)	\$2,771,768	\$ 31,073	\$10,624	\$ 92
Individually evaluated (3)	133,413	19,771	—	—
<b>Total</b>	<b>\$2,905,181</b>	<b>\$ 50,844</b>	<b>\$10,624</b>	<b>\$ 92</b>

(1) Represents loans collectively evaluated for impairment in accordance with ASC 450-20, Loss Contingencies, and pursuant to amendments by ASU 2010-20 regarding allowance for unimpaired loans. These loans had a weighted average risk rating of 5.3 and 5.2 at September 30, 2017 and December 31, 2016, respectively, based on the Company's internally developed 12 point scale for the Leveraged Finance and Real Estate loans.

(2) Excludes \$407.5 million at September 30, 2017 and \$403.7 million at December 31, 2016 of Leveraged Finance loans which the Company elected to record at fair value.

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

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

Recorded Investment in Nonaccrual Loans	September 30,	
	2017	December 31, 2016
	(\$ in thousands)	
Nonaccrual loans	\$103,819	\$ 99,233
Less: Deferred loan fees	(6,533 )	(6,485 )
Add back: Interest receivable	73	116
<b>Total</b>	<b>\$97,359</b>	<b>\$ 92,864</b>

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

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

Group I:

• extension of principal repayment term

• principal holidays

• interest rate adjustments

Group II:

• partial forgiveness

• conversion of debt to equity

19

---

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

A summary of the types of concessions that the Company made with respect to TDRs at September 30, 2017 and December 31, 2016 is provided below:

	Group I	Group II
	(\$ in thousands)	
September 30, 2017	\$85,095	\$54,392
December 31, 2016	\$114,803	\$77,061

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

For the three and nine months ended September 30, 2017, the Company recorded \$8.6 million and \$21.6 million, respectively, of partial charge-offs related to loans previously classified as TDR. As of September 30, 2017, the Company had not removed the TDR classification from any loan previously identified as such during the quarter, but had charged-off, sold and received repayments of outstanding TDRs.

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

Below is a summary of the Company's loans which were newly classified as TDR and existing TDR loans which subsequently defaulted, in each during the periods presented.

	Pre-Modification	Post-Modification	Investment
	Outstanding	Outstanding	in TDR
As of the Three Months Ended	Recorded	Recorded	Subsequently
September 30, 2017	Investment	Investment	Defaulted
	(\$ in thousands)		
Leveraged Finance	\$5,815	\$ 5,277	\$ 5,277
Total	\$5,815	\$ 5,277	\$ 5,277
	Pre-Modification	Post-Modification	Investment
	Outstanding	Outstanding	in TDR
As of the Nine Months Ended	Recorded	Recorded	Subsequently
September 30, 2017	Outstanding	Outstanding	in TDR
	Recorded	Recorded	Subsequently

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

	Investment	Investment	Defaulted
	(\$ in thousands)		
Leveraged Finance	\$5,815	\$ 5,277	\$ 34,735
Total	\$5,815	\$ 5,277	\$ 34,735

	Pre-Modification	Post-Modification	Investment
	Outstanding		in TDR
As of the Three Months Ended	Recorded	Recorded	Subsequently
September 30, 2016	Investment		Defaulted
	(\$ in thousands)		
Leveraged Finance	\$8,372	\$ 8,473	\$ —
Real Estate	—	—	—
Total	\$8,372	\$ 8,473	\$ —

20

---

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

As of the Nine Months Ended	Pre-Modification	Post-Modification	Investment
	Recorded	Recorded	in TDR
September 30, 2016	Investment	Investment	Defaulted
	(\$ in thousands)		
Leveraged Finance	\$10,147	\$ 9,781	\$ —
Real Estate (1)	—	—	4,483
Total	\$10,147	\$ 9,781	\$ 4,483

(1) Amount reflects charge-off on an impaired Real Estate TDR that was taken prior to transfer to held-for-sale. The following sets forth a breakdown of troubled debt restructurings at September 30, 2017 and December 31, 2016:

As of September 30, 2017 (\$ in thousands)	Accrual Status		TDR	Specific	For the nine months
	Accruing	Nonaccrual			Charged-off
Loan Type			Balance	Allowance	
Leveraged Finance	\$16,025	\$ 69,070	\$85,095	\$ 5,279	\$ 21,554
Total	\$16,025	\$ 69,070	\$85,095	\$ 5,279	\$ 21,554

As of December 31, 2016 (\$ in thousands)	Accrual Status		Impaired	Specific	For the year
	Accruing	Nonaccrual			Charged-off
Loan Type			Balance	Allowance	
Leveraged Finance	\$24,367	\$ 90,436	\$114,803	\$ 15,939	\$ 26,684
Total	\$24,367	\$ 90,436	\$114,803	\$ 15,939	\$ 26,684

The Company classifies a loan as delinquent when it is over 60 days past due. An age analysis of the Company's delinquent receivables is as follows:

	60-89 Days	Total	Current	Total Loans	Investment in
	Greater than Past Due	Past Due			> 60 Days & Accruing
	(\$ in thousands)				
September 30, 2017					
Leveraged Finance	\$—\$ 36,656	\$36,656	\$3,012,918	\$3,049,574	\$ 22,596
Real Estate	— —	—	10,716	10,716	—
Total	\$—\$ 36,656	\$36,656	\$3,023,634	\$3,060,290	\$ 22,596

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

	60-89 Days Greater than Past Due90 Days (\$ in thousands)	Total Past Due	Current	Total Loans	Investment in > 60 Days & Accruing
December 31, 2016					
Leveraged Finance	\$—\$ 21,135	\$21,135	\$3,287,791	\$3,308,926	\$ —
Real Estate	— —	—	10,624	10,624	—
Total	\$—\$ 21,135	\$21,135	\$3,298,415	\$3,319,550	\$ —

A general allowance is provided for loans within the amortized portfolio that are not impaired. The Company employs a variety of internally developed and third-party modeling and estimation tools for measuring credit risk, which are used in developing an allowance for loan losses on outstanding loans held at amortized cost. The Company's allowance framework addresses economic conditions, capital market liquidity and industry circumstances from both a top-down and bottom-up perspective. The Company considers and evaluates a number of factors, including but not limited to, changes in economic conditions, credit availability, industry, loss emergence period, and multiple obligor concentrations in assessing both probabilities of default and loss severities as part of the general component of the allowance for loan losses. The Company continually evaluates the appropriateness of its allowance for credit losses methodology. Based on the Company's evaluation process to determine the level of the allowance for loan losses, management believes the allowance to be adequate as of September 30, 2017 in light of the estimated known and inherent risks identified through its analysis.

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

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

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

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

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

The Company periodically reviews its allowance for credit loss methodology to assess any necessary adjustments based upon changing economic and capital market conditions. If the Company determines that changes in its allowance for credit losses methodology are advisable, as a result of changes in the economic environment or otherwise, the revised allowance methodology may result in higher or lower levels of allowance.

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

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

	Three Months Ended September 30, 2017 Leveraged		
	Real		Total
	Finance	Estate	
	(\$ in thousands)		
Balance, beginning of period	\$47,192	\$92	\$47,284
Provision (reversal) for credit losses—general	(2,369 )	1	(2,368 )
Provision for credit losses—specific	3,862	—	3,862
Loans charged off, net of recoveries	(8,560 )	—	(8,560 )
Balance, end of period	\$40,125	\$93	\$40,218
Balance, end of period—specific	\$11,665	\$—	\$11,665
Balance, end of period—general	\$28,460	\$93	\$28,553
Average balance of impaired loans	\$131,888	\$—	\$131,888
Interest recognized from impaired loans	\$1,499	\$—	\$1,499
Loans (1)			
Loans individually evaluated with specific allowance	\$100,085	\$—	\$100,085
Loans individually evaluated with no specific allowance	53,631	—	53,631
Loans collectively evaluated with general allowance	2,488,393	10,716	2,499,109
Total loans	\$2,642,109	\$10,716	\$2,652,825

(1)Excludes \$407.6 million of Leveraged Finance loans which the Company elected to record at fair value.

	Nine Months Ended September 30, 2017 Leveraged		
	Real		Total
	Finance	Estate	
	(\$ in thousands)		
Balance, beginning of period	\$51,316	\$ 92	\$51,408
Provision for credit losses—general	(3,085 )	1	(3,084 )
Provision for credit losses—specific	13,424	—	13,424
Loans charged off, net of recoveries	(21,530 )	—	(21,530 )
Balance, end of period	\$40,125	\$ 93	\$40,218
Balance, end of period—specific	\$11,665	\$ —	\$11,665
Balance, end of period—general	\$28,460	\$ 93	\$28,553
Average balance of impaired loans	\$149,552	\$ —	\$149,552
Interest recognized from impaired loans	\$5,400	\$ —	\$5,400

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

	Three Months Ended September 30, 2016			
	Leveraged		Equipment	
	Finance	Real Estate	Finance	Total
	(\$ in thousands)			
Balance, beginning of period	\$62,645	\$91	\$ 1,307	\$64,043
Provision for credit losses—general	349	1	(14 )	336
Provision for credit losses—specific	3,234	—	—	3,234
Reclass of Equipment Finance to Assets held-for-sale	—	—	(1,293 )	(1,293 )
Loans charged off, net of recoveries	46	—	—	46
Balance, end of period	\$66,274	\$92	\$ —	\$66,366
Balance, end of period—specific	\$36,160	\$—	\$ —	\$36,160
Balance, end of period—general	\$30,114	\$92	\$ —	\$30,206
Average balance of impaired loans	\$154,695	\$21,942	\$ —	\$176,637
Average net book value of impaired leases	\$—	\$—	\$ 623	\$623
Interest recognized from impaired loans	\$1,627	\$296	\$ —	\$1,923
Loans (1)				
Loans individually evaluated with specific allowance	\$105,099	\$—	\$ —	\$105,099
Loans individually evaluated with no specific allowance	44,598	7,160	—	51,758
Loans collectively evaluated with general allowance	2,725,028	10,582	—	2,735,610
Total loans	\$2,874,725	\$17,742	\$ —	\$2,892,467

(1) Excludes \$389.3 million of Leveraged Finance loans which the Company elected to record at fair value.

	Nine Months Ended September 30, 2016				
	Leveraged Business		Equipment		Total
	Finance	Credit	Real Estate	Finance	
	(\$ in thousands)				
Balance, beginning of period	\$54,788	\$1,991	\$656	\$ 1,291	\$58,726
Provision for credit losses—general	1,774	(172 )	1,010	2	2,614
Provision for credit losses—specific	18,115	—	4,177	—	22,292
Reversal due to sale of Business Credit	—	(1,819 )	—	(1,293 )	(3,112 )
Loans charged off, net of recoveries	(8,403 )	—	(5,751 )	—	(14,154 )
Balance, end of period	\$66,274	\$—	\$92	\$ —	\$66,366
Balance, end of period—specific	\$36,160	\$—	\$—	\$ —	\$36,160
Balance, end of period—general	\$30,114	\$—	\$92	\$ —	\$30,206
Average balance of impaired loans	\$169,690	\$—	\$30,699	\$ —	\$200,389
Average net book value of impaired leases	\$—	\$—	\$—	\$ 698	\$698
Interest recognized from impaired loans	\$6,606	\$—	\$1,128	\$ 12	\$7,746

Included in the allowance for credit losses at September 30, 2017 and December 31, 2016 is an allowance for unfunded commitments of \$0.5 million, which is recorded as a component of other liabilities on the Company's consolidated balance sheet with changes recorded in the provision for credit losses on the Company's consolidated statement of operations. The methodology for determining the allowance for unfunded commitments is consistent with the methodology for determining the allowance for loan losses.

During the nine months ended September 30, 2017, the Company recorded a total provision for credit losses of \$10.3 million. The Company decreased its allowance for credit losses to \$40.2 million as of September 30, 2017 from \$51.4 million at December 31, 2016. The general allowance for credit losses covers probable incurred losses in the Company's loan portfolio with respect to loans for which no specific impairment has been identified. When a loan is classified as impaired, the loan is evaluated for a specific allowance and a specific provision may be recorded, thereby removing it from consideration under the general component of the allowance analysis. Loans that are deemed to be uncollectible are charged off and deducted from the allowance, and recoveries on loans previously charged off are netted against loans charged off. A specific provision for credit losses is recorded with respect to impaired loans for which it is probable that the Company will be unable to collect all amounts due in accordance with the contractual terms of the loan agreement for which there is impairment recognized. The outstanding balance of impaired loans, which include all of the outstanding balances of the Company's delinquent loans and its troubled debt restructurings, as a percentage of "Loans, net" was 5% and 4% as of September 30, 2017 and December 31, 2016, respectively.

Note 5. Restricted Cash

Restricted cash as of September 30, 2017 and December 31, 2016 was as follows:

	September 30, 2017	December 31, 2016
	(\$ in thousands)	
Collections on loans pledged to credit facilities	\$49,694	\$ 43,822
Principal and interest collections on loans held in trust and		
prefunding amounts	199,156	216,501
Customer escrow accounts	2,803	2,320
Total	\$251,653	\$ 262,643

As of September 30, 2017, the Company had the ability to use \$170.7 million of restricted cash to fund new or existing loans.

Note 6. Investments in Debt Securities, Available-for-Sale

Amortized cost of investments in debt securities as of September 30, 2017 and December 31, 2016 was as follows:

	September 30, 2017	December 31, 2016
	(\$ in thousands)	
Investments in debt securities—gross	\$182,422	\$ 132,180
Unamortized discount	(9,974 )	(6,743 )
Investments in debt securities—amortized cost	\$172,448	\$ 125,437

At September 30, 2017 and December 31, 2016 investments in non-NewStar managed issuers totaled \$74.0 million and \$75.8 million, respectively. NewStar managed issuers are off balance sheet credit funds in which NewStar holds 5% of each class of notes of a securitization to comply with European Union (“EU”) risk retention rules. These managed issuers are considered unconsolidated VIEs and are discussed in Note 11.

The amortized cost, gross unrealized holding gains, gross unrealized holding losses, and fair value of available-for-sale securities at September 30, 2017 and December 31, 2016 were as follows:

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

	Gross		Gross	
	unrealized		unrealized	
Amortized	holding	holding	holding	Fair
cost	gains	losses	losses	value
(\$ in thousands)				
<b>September 30, 2017</b>				
Collateralized loan obligations	\$ 172,448	\$ 4,350	\$ (961 )	\$ 175,837
Investment in debt securities	\$ 172,448	\$ 4,350	\$ (961 )	\$ 175,837

	Gross		Gross	
	unrealized		unrealized	
Amortized	holding	holding	holding	Fair
cost	gains	losses	losses	value
(\$ in thousands)				
<b>December 31, 2016</b>				
Collateralized loan obligations	\$ 125,437	\$ 286	\$ (6,416 )	\$ 119,307
Investment in debt securities	\$ 125,437	\$ 286	\$ (6,416 )	\$ 119,307

During the three and nine months ended September 30, 2017, the Company purchased \$23.1 million and \$52.7 million of debt securities, \$21.5 million were purchased to satisfy EU risk retention rules, redeemed a \$5.9 million par value investment in debt securities, and made a \$0.5 million par paydown. During the nine months ended September 30, 2016, the Company did not purchase or sell any debt securities available for sale and a \$6.0 million investment in debt securities was redeemed at par.

The Company did not record any net "Other-Than-Temporary Impairment" charges during the three and nine months ended September 30, 2017.

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

The following is an analysis of the continuous periods during which the Company has held investment positions which were carried at an unrealized loss as of September 30, 2017 and December 31, 2016:

	September 30, 2017		
	Greater than		
	Less than	or	Equal to
	12 Months	12 Months	Total
	(\$ in thousands)		
Number of positions	6	2	8
Fair value	\$19,895	\$3,519	\$23,414
Amortized cost	20,598	3,777	24,375
Unrealized loss	\$(703 )	\$(258 )	\$(961 )

	December 31, 2016		
	Greater than		
	Less than	or	Equal to
	12 Months	12 Months	Total
	(\$ in thousands)		
Number of positions	3	17	20
Fair value	\$4,811	\$68,737	\$73,548
Amortized cost	4,885	75,079	79,964
Unrealized loss	\$(74 )	\$(6,342 )	\$(6,416 )

As a result of the Company's evaluation of the securities, management concluded that the unrealized losses at September 30, 2017 and December 31, 2016 were caused by changes in market prices driven by interest rates and credit spreads. The Company's evaluation of impairment include quotes from third party pricing services, adjustments to prepayment speeds, delinquency, an analysis of expected cash flows, interest rates, market discount rates, other contract terms, and the timing and level of losses on the loans and leases within the underlying trusts. At September 30, 2017, the Company has determined that it is not more likely than not that it will be required to sell the securities before the Company recovers its amortized cost basis in the security. The Company has also determined that there has not been an adverse change in the cash flows expected to be collected. Based upon the Company's impairment review process, and the Company's ability and intent to hold these securities until maturity or a recovery of fair value, the decline in the value of these investments is not considered to be "Other Than Temporary."

Maturities of debt securities classified as available-for-sale were as follows at September 30, 2017 and December 31, 2016:

	September 30, 2017		December 31, 2016	
	Amortized		Amortized	
	cost	Fair value	cost	Fair value
	(\$ in thousands)			
Available-for-sale:				
Due one year or less	\$—	\$—	\$91	\$20
Due after one year through five years	—	—	—	—
Due after five years through ten years	120,183	123,592	53,177	48,404
Due after ten years through fifteen years	52,265	52,245	72,169	70,883
Total	\$172,448	\$175,837	\$125,437	\$119,307

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

## Note 7. Borrowings

### Credit Facilities

As of September 30, 2017 the Company had two credit facilities through certain of its wholly owned subsidiaries: (i) a \$615.0 million credit facility with syndicated lenders agented by Wells Fargo Bank, National Association (“Wells Fargo”) to fund leveraged finance loans, and (ii) a \$250.0 million credit facility with Citibank, N.A. (“Citibank”) to fund leveraged finance loans.

The Company must comply with various covenants under these facilities. The breach of certain of these covenants could result in a termination event and the exercise of remedies if not cured. At September 30, 2017, the Company was in compliance with all such covenants. These covenants are customary and include, but are not limited to, failure to service debt obligations, failure to meet liquidity covenants and tangible net worth covenants, and failure to remain within prescribed facility portfolio delinquency, charge-off levels, and overcollateralization tests.

The Company’s \$615.0 million credit facility with syndicated lenders agented by Wells Fargo to fund leveraged finance loans had an outstanding balance of \$368.9 million and unamortized deferred financing fees of \$5.0 million as of September 30, 2017. Interest on this facility accrues at a variable rate per annum. The facility matures on August 10, 2020. The facility provides for a revolving reinvestment period which ends on August 10, 2018, with a two-year amortization period.

The Company’s \$250.0 million credit facility with Citibank to fund leveraged finance loans had a \$95.0 million outstanding balance and unamortized deferred financing fees of \$1.9 million as of September 30, 2017. Interest on this facility accrues at a variable rate per annum. The facility matures on May 5, 2020. It provides for a revolving reinvestment period which ends on May 5, 2018, with a two-year amortization period.

### Senior notes

On April 22, 2015, the Company issued \$300.0 million in aggregate principal amount of 7.25% Senior Notes due 2020 (the “2020 Notes”). On November 9, 2015, the Company issued an additional \$80.0 million in aggregate principal amount of 2020 Notes, at a debt discount of \$0.8 million which will amortize over the life of the 2020 Notes. The Company used a portion of the net proceeds from the April notes offering to repay in full its corporate credit facility with Fortress Credit Corp. The 2020 Notes mature on May 1, 2020, and bear interest at a rate of 7.25% per annum, which is payable semi-annually on May 1 and November 1 of each year. On or after May 1, 2017, the Company may redeem the 2020 Notes, in whole or in part, at redemption prices specified in the 2020 Notes plus accrued and unpaid interest thereon. In addition, if the Company undergoes a change of control, the Company will be required to make an offer to purchase each holder’s 2020 Notes at a price equal to 101% of the principal amount of the 2020 Notes, plus accrued and unpaid interest. As of September 30, 2017, unamortized deferred financing fees were \$4.3 million.

### Subordinated notes

On December 4, 2014, the Company completed the initial closing of an investment of long-term capital from funds sponsored by Franklin Square Capital Partners (“Franklin Square”) and sub-advised by GSO Capital Partners at which the Franklin Square funds purchased \$200.0 million of 10-year subordinated notes (the “Subordinated Notes”), which rank junior to the Company’s existing and future senior debt. During 2015, the Company drew an additional \$75 million of these Subordinated Notes. The Company drew the remaining \$25 million in January 2016. The Subordinated Notes were recorded at par less the initial relative fair value of the warrants issued in connection with the investment in December 2014 and January 2015, which was \$48.6 million as of September 30, 2017 and \$53.7 million as of December 31, 2016. The debt discount will amortize over the life of the notes and will be recorded as non-cash interest expense as the Subordinated Notes accrete to par value. As of September 30, 2017, unamortized deferred financing fees were \$4.4 million. The Subordinated Notes bear interest at 8.25% and include a

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

27

---

## Term Debt

On July 20, 2017, in connection with the acquisition of FSCM, the Company assumed the indebtedness associated with the Natixis credit agreement dated September 28, 2015. The proceeds under this credit agreement were used solely to purchase the interests held in a FSCM-managed CLO to comply with risk retention requirements. The credit agreement matures on September 29, 2027.

The following table sets forth selected information with respect to the Natixis Term Debt:

	Outstanding balance September 30, 2017 (\$ in thousands)	Interest rate
<b>Natixis Term Debt</b>		
Class A-1 Notes	\$ 12,972	Libor + 1.92%
Class A-2 Notes	1,597	Libor + 2.81%
Class B Notes	1,552	Libor + 3.72%
Class C Notes	852	Libor + 4.85%
	\$ 16,973	

## Term Debt Securitizations

**2012-2 CLO.** On December 18, 2012, the Company completed a term debt securitization transaction. In conjunction with this transaction the Company established a separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2012-2 LLC (the "2012-2 CLO") and sold and contributed \$325.9 million in loans and investments (including unfunded commitments), or portions thereof, to the 2012-2 CLO. The Company remains the servicer of the loans. Simultaneously with the initial sale and contribution, the 2012-2 CLO issued \$263.3 million of notes to institutional investors. The Company retained \$62.6 million, comprising 100% of the 2012-2 CLO's membership interests, Class E notes, Class F notes, and subordinated notes. On June 12, 2015, the Company sold 100% of the 2012-2 CLO's Class E Notes totaling \$16.3 million to institutional investors. At September 30, 2017, the \$142.3 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$188.6 million. At September 30, 2017, unamortized deferred financing fees were \$0.2 million. The 2012-2 CLO permitted reinvestment of collateral principal repayments for a three-year period which ended in January 2016.

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

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

Notes	Interest	Legal final
-------	----------	-------------

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

	originally issued	Outstanding balance September 30, 2017	rate	maturity
(\$ in thousands)				
2012-2 CLO				
Class A	\$ 190,700	\$ 53,383	Libor+1.90%	January 20, 2023
Class B	26,000	26,000	Libor+3.25%	January 20, 2023
Class C	35,200	35,200	Libor+4.25%	January 20, 2023
Class D	11,400	11,400	Libor+6.25%	January 20, 2023
Class E	16,300	16,300	Libor+6.75%	January 20, 2023
	\$ 279,600	\$ 142,283		

2014-1 CLO. On April 17, 2014, the Company completed a term debt securitization transaction through its separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2014-1 LLC (the “2014-1 CLO”) and sold and contributed \$249.6 million in loans and investments (including unfunded commitments), or portions thereof, to the 2014-1 CLO. The Company remains the servicer of the loans. Simultaneously with the initial sale and contribution, the 2014-1 CLO issued \$289.5 million of notes to institutional investors. The Company retained \$58.9 million, comprising 100% of the 2014-1 CLO’s membership

interests, Class E notes, Class F notes, and subordinated notes. At September 30, 2017, the \$289.5 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$348.4 million. At September 30, 2017, unamortized deferred financing fees were \$1.5 million. The 2014-1 CLO permits reinvestment of collateral principal repayments for a four-year period ending in April 2018. Should the Company determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes. Subject to the terms of the Indenture, the Company has the right to redeem the 2014-1 CLO following the expiration of the non-call period which occurred on the payment date in April 2016.

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

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

	Notes originally issued (\$ in thousands)	Outstanding balance September 30, 2017	Interest rate	Legal final maturity
2014-1 CLO				
Class A	\$202,500	\$202,500	Libor+1.80%	April 20, 2025
Class B-1	20,000	20,000	Libor+2.60%	April 20, 2025
Class B-2	13,250	13,250	(1)	April 20, 2025
Class C	30,250	30,250	Libor+3.60%	April 20, 2025
Class D	23,500	23,500	Libor+4.75%	April 20, 2025
	\$289,500	\$289,500		

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

2015-1 CLO. On March 20, 2015, the Company completed a term debt securitization transaction through its separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2015-1 LLC (the "2015-1 CLO") and sold and contributed \$336.3 million in loans and investments (including unfunded commitments), or portions thereof, to the 2015-1 CLO. The Company remains the servicer of the loans. Simultaneously with the initial sale and contribution, the 2015-1 CLO issued \$410.3 million of notes to institutional investors. The Company retained \$85.8 million, comprising 100% of the 2015-1 CLO's membership interests and subordinated notes. At September 30, 2017, the \$410.3 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$496.1 million. At September 30, 2017, unamortized deferred financing fees were \$2.6 million. The 2015-1 CLO permits reinvestment of collateral principal repayments for a four-year period ending in April 2019. Should the Company determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes. Subject to the terms of the Indenture, the Company has the right to redeem the 2015-1 CLO following the expiration of the non-call period

which occurred on the payment date in April 2017.

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

29

---

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

	Notes originally issued	Outstanding balance September 30, 2017	Interest rate	Legal final maturity
2015-1 CLO				
Class A-1	\$253,500	\$253,500	Libor+1.80%	January 20, 2027
Class A-2	35,000	35,000	(1)	January 20, 2027
Class B	50,000	50,000	Libor+2.80%	January 20, 2027
Class C	38,500	38,500	Libor+3.85%	January 20, 2027
Class D	33,250	33,250	Libor+5.50%	January 20, 2027
	\$410,250	\$410,250		

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

2015-2 CLO. On September 15, 2015, the Company completed a term debt securitization transaction through its separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2015-2 LLC (the “2015-2 CLO”) and sold and contributed \$298.4 million in loans and investments (including unfunded commitments), or portions thereof, to the 2015-2 CLO. The Company remains the servicer of the loans. Simultaneously with the initial sale and contribution, the 2015-2 CLO issued \$327.8 million of notes to institutional investors. The Company retained \$70.1 million, comprising 100% of the 2015-2 CLO’s membership interests and a portion of the Class E notes. At September 30, 2017, the \$327.8 million of outstanding drawn notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$397.8 million. At September 30, 2017, unamortized deferred financing fees were \$2.4 million. The 2015-2 CLO permits reinvestment of collateral principal repayments for a four-year period ending in August 2019. Should the Company determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes. Subject to the terms of the Indenture, the Company has the right to redeem the 2015-2 CLO following the expiration of the non-call period which occurred on the payment date in August 2017.

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

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

	Notes originally issued	Outstanding balance September 30, 2017	Interest rate	Legal final maturity
--	-------------------------------	---	------------------	-------------------------

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

(\$ in thousands)

2015-2 CLO				
Class A-1	\$ 205,000	\$ 205,000	Libor+2.00%	August 25, 2027
Class A-2	23,000	23,000	(1)	August 25, 2027
Class B	40,000	40,000	Libor+2.90%	August 25, 2027
Class C	26,250	26,250	Libor+3.95%	August 25, 2027
Class D	28,500	28,500	Libor+5.25%	August 25, 2027
Class E	5,000	5,000	Libor+7.50%	August 25, 2027
	\$ 327,750	\$ 327,750		

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

2016-1 CLO. On March 2, 2016, the Company completed a term debt securitization transaction through its separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2016-1 LLC (the "2016-1 CLO") and sold and contributed \$247.3 million in loans and investments (including unfunded commitments), or portions thereof, to the 2016-1 CLO. The Company remains the servicer of the loans. Simultaneously with the initial sale and contribution, the 2016-1 CLO issued \$255.8 million of notes to institutional investors. The Company retained \$92.2 million, comprising 100% of the 2016-1 CLO's membership interests, and the Class D and Class E notes. At September 30, 2017, the \$263.3 million of outstanding drawn notes were

30

collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$348.0 million. At September 30, 2017, unamortized deferred financing fees were \$2.1 million. The 2016-1 CLO permits reinvestment of collateral principal repayments for a four-year period ending in February 2020. Should the Company determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes. Subject to the terms of the Indenture, the Company has the right to redeem the 2016-1 CLO following the expiration of the non-call period on the payment date in February 2018.

The following table sets forth selected information with respect to the 2016-1 CLO:

Notes	originally issued	Outstanding balance September 30, 2017	Interest rate	Legal final maturity
2016-1 CLO				
Class A-1	\$ 176,500	\$ 176,500	Libor+2.30%	February 25, 2028
Class A-2	20,000	20,000	(1)	February 25, 2028
Class B	36,750	36,750	Libor+3.75%	February 25, 2028
Class C	22,500	22,500	Libor+5.40%	February 25, 2028
Class D	7,500	7,500	Libor+5.50%	February 25, 2028
	\$263,250	\$ 263,250		

(1) Class A-2 Notes accrue interest at a fixed rate of 3.44%.

Arch Street CLO. On September 15, 2016, NewStar Capital LLC completed a \$409.8 million broadly syndicated loan securitization. The notes offered in the collateralized loan obligation (“Arch Street CLO”) were issued by Arch Street CLO, Ltd., an exempted company incorporated under the laws of the Cayman Islands, and (with the exception of the Class E and F notes) by Arch Street CLO, LLC, a Delaware limited liability company (each a subsidiary of NewStar Capital and collectively, “Arch Street”). The Arch Street CLO notes are backed by a diversified portfolio of broadly syndicated loans purchased and serviced by the Company. Investors purchased approximately \$370.3 million of the Arch Street CLO notes, representing approximately 90.4% of the total capitalization of Arch Street. The Company retained all of the Class F notes and subordinated notes which together totaled approximately \$39.5 million, representing approximately 9.6% of the total capitalization of Arch Street. At September 30, 2017, the outstanding note balance was \$367.8 million and unamortized deferred financing fees were \$3.7 million. The reinvestment period is expected to end in October 2020 and scheduled to mature in October 2028.

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

The following table sets forth selected information with respect to the Arch Street CLO:

Notes	originally issued	Outstanding balance September 30, 2017	Interest rate	Legal final maturity
(\$ in thousands)				
<b>Arch Street CLO</b>				
Class X	\$2,500	\$ -	Libor+1.25%	October 20, 2028
Class A	256,000	256,000	Libor+1.65%	October 20, 2028
Class B	48,000	48,000	Libor+2.24%	October 20, 2028
Class C	20,000	20,000	Libor+3.00%	October 20, 2028
Class D	22,750	22,750	Libor+4.20%	October 20, 2028
Class E	21,000	21,000	Libor+6.95%	October 20, 2028
	\$370,250	\$ 367,750		

2017-1 CLO. On March 20, 2017, the Company completed a term debt securitization transaction through its separate single-purpose bankruptcy-remote subsidiary, NewStar Commercial Loan Funding 2017-1 LLC (the “2017-1 CLO”). This securitization was a refinance of the NewStar Commercial Loan Funding 2013-1 LLC term debt securitization completed on September 11, 2013.

The Company remains the servicer of the loans. In connection with the refinance the Company accelerated and recognized deferred financing fees of \$0.3 million related to the 2013-1 CLO. Simultaneously with the refinance, the 2017-1 CLO issued \$328.0 million of replacement notes to institutional investors. The Company retained the Class E-N replacement notes and all of the equity which together totaled \$69.3 million. At September 30, 2017, the \$303.0 million of outstanding drawn replacement notes were collateralized by the specific loans and investments, principal collection account cash and principal payment receivables totaling \$372.3 million. At September 30, 2017, unamortized deferred financing fees were \$3.0 million. The reinvestment period is expected to end in March 2019 and the replacement notes are scheduled to mature in October 2027. Should the Company determine that reinvestment of collateral principal repayments are impractical in light of market conditions or if collateral principal repayments are not reinvested within a prescribed timeframe, such funds may be used to repay the outstanding notes. Subject to the terms of the Indenture, the Company has the right to redeem the 2017-1 CLO following the expiration of the non-call period on the payment date in March 2019.

The Company receives a loan collateral management fee and excess interest spread. The Company also receives payments with respect to the classes of notes it owns in accordance with the transaction documents. The Company expects to receive a principal distribution as owner of the membership interests when the term debt is retired. If loan collateral in the 2017-1 CLO is in default under the terms of the indenture, the excess interest spread from the 2017-1 CLO may not be distributed if the overcollateralization ratio, or other collateral quality tests, are not satisfied.

The following table sets forth selected information with respect to the 2017-1 CLO:

Notes	Outstanding	Interest	Legal final
originally issued	balance September 30, 2017	rate	maturity
(\$ in thousands)			
<b>2017-1 CLO</b>			
Class A-T-N	\$ 207,000	\$ 207,000	Libor+1.78% September 22, 2027
Class A-R-N	25,000	-	Libor+1.78% September 22, 2027
Class B-N	40,000	40,000	Libor+2.50% September 22, 2027
Class C-N	32,000	32,000	Libor+3.50% September 22, 2027
Class D-N	24,000	24,000	Libor+5.10% September 22, 2027
	\$ 328,000	\$ 303,000	

2013-1 CLO. On March 20, 2017, the Company refinanced the 2013-1 LLC and issued the 2017-1 CLO Replacement Notes. The Company accelerated and recognized deferred financing fees of \$0.3 million related to the refinancing of the 2013-1 CLO.

#### Note 8. Repurchase Agreements

The Company has entered into a repurchase transaction with Deutsche Bank AG, pursuant to the terms of a Global Master Repurchase Agreement (2000 version), dated as of February 13, 2015 between Deutsche Bank AG and NS Bond Funding I LLC (the "Deutsche Bank Repurchase Agreement"). Pursuant to the Deutsche Bank Repurchase

Agreement, Deutsche Bank AG will purchase securities and simultaneously agree to sell the securities back to the Company at a specified date. Under the terms of the Deutsche Bank Repurchase Agreement, the Company is required at all times to maintain a level of overcollateralization for the obligations, which is maintained through daily margining. As of September 30, 2017, there was no outstanding balance under the Deutsche Bank Repurchase Agreement. The Company has made certain representations and warranties and is required to comply with various covenants and requirements customary for financing arrangements of this nature.

The Company has entered into a repurchase transaction with Citigroup Global Markets, pursuant to the terms of a Global Master Repurchase Agreement (1996 version), dated as of March 16, 2015 between Citigroup Global Markets and NS Loan Originator LLC (the "Citigroup Repurchase Agreement"). Pursuant to the Citigroup Repurchase Agreement, Citigroup Global Markets will purchase securities and simultaneously agree to sell the securities back to the Company at a specified date. Under the terms of the Citigroup Repurchase Agreement, the Company is required at all times to maintain a level of overcollateralization for the obligations, which is maintained through daily margining. As of September 30, 2017, the outstanding balance was \$49.6 million. The Company has made certain representations and warranties and is required to comply with various covenants and requirements customary for financing arrangements of this nature.

The Company has entered into a repurchase transaction with JP Morgan Chase Bank pursuant to the terms of a Global Master Repurchase Agreement (1996 version), dated as of May 1, 2015 between JP Morgan Chase Bank and NS Bond Funding II LLC (the "JP Morgan Repurchase Agreement"). Pursuant to the JP Morgan Repurchase Agreement, JP Morgan Chase Bank will purchase securities and simultaneously agree to sell the securities back to the Company at a specified date. Under the terms of the JP Morgan Repurchase Agreement, the Company is required at all times to maintain a level of overcollateralization for the obligations, which is

maintained through daily margining. As of September 30, 2017, the outstanding balance was \$29.1 million. The Company has made certain representations and warranties and is required to comply with various covenants and requirements customary for financing arrangements of this nature.

The Company has entered into a repurchase transaction with Natixis Securities Americas LLC pursuant to the terms of a Global Master Repurchase Agreement (2000 version), dated as of October 14, 2015 between Natixis Securities Americas LLC and NS Bond Funding III LLC (the “Natixis Repurchase Agreement”). Pursuant to the Natixis Repurchase Agreement, Natixis Securities Americas LLC will purchase securities and simultaneously agree to sell the securities back to the Company at a specified date. Under the terms of the Natixis Repurchase Agreement, the Company is required at all times to maintain a level of overcollateralization for the obligations, which is maintained through daily margining. As of September 30, 2017, the outstanding balance was \$1.9 million. The Company has made certain representations and warranties and is required to comply with various covenants and requirements customary for financing arrangements of this nature.

## Note 9. Stockholders’ Equity

### Stockholders’ Equity

As of September 30, 2017 and December 31, 2016, the Company’s authorized capital consists of preferred and common stock and the following was authorized and outstanding:

	September 30, 2017		December 31, 2016	
	Shares	Shares	Shares	Shares
	authorized	outstanding	authorized	outstanding
	(In thousands)			
Preferred stock	5,000	—	5,000	—
Common stock	145,000	41,481	145,000	42,820

### Preferred Stock

The Company’s authorized capital stock includes 5,000,000 shares of preferred stock with a par value of \$0.01 per share, all of which remain undesignated.

### Common Stock

On December 9, 2016, the Company’s Board of Directors authorized the repurchase of up to \$30.0 million of the Company’s common stock from time to time on the open market or in privately negotiated transactions. The timing and amount of any shares purchased under the repurchase program will be determined by our management based on its evaluation of market conditions and other factors. The repurchase program commenced immediately following the expiration of the prior stock repurchase program on December 31, 2016. The repurchase program will expire on December 31, 2017 unless extended by the Board and may be suspended or discontinued at any time without notice. As of September 30, 2017, the Company had repurchased 1,740,154 shares of common stock under this program at a weighted average price per share of \$10.17.

On February 14, 2017, our Board of Directors declared a quarterly cash dividend of \$0.02 per share which was paid on March 17, 2017. On May 2, 2017, the Board of Directors declared a quarterly cash dividend of \$0.02 per share which was paid on June 15, 2017. On July 31, 2017, the Board of Directors declared a quarterly cash dividend of \$0.02 per share which was paid on September 15, 2017 to stockholders of record on August 29, 2017.

#### Warrants

On January 23, 2015, the Company completed its December 4, 2014 issuance of warrants as part of the strategic relationship with Franklin Square Capital Partners (“Franklin Square”). The Company issued the second tranche of warrants to purchase 2,500,000 shares of its common stock subject to the same terms as the warrants that were issued on December 4, 2014, bringing the total warrants to purchase shares of common stock to 12,000,000.

The terms of the warrants contain standard adjustments to the exercise price and warrant shares to adjust for the effect of certain distributions, including cash dividends. No adjustments are required until cumulative adjustments would result in a one percent change to the exercise price or number of warrant shares. To date, the cash dividends declared and paid by the Company have not resulted in any adjustment to the warrants’ exercise price or the number of shares underlying the warrants, because such distributions have not exceeded the minimum adjustment amounts.

## Restricted Stock

During the nine months ended September 30, 2017, the Company issued 284,241 shares of restricted stock to certain employees of the Company pursuant to the Company's 2006 Incentive Plan, as amended and 56,698 shares of restricted stock to certain members of its Board of Directors. The fair value of the shares of restricted stock is equal to the closing price of the Company's stock on the date of issuance. The shares of restricted stock issued to employees of the Company vest in three equal installments on each of the first three anniversaries of the date of grant.

Restricted stock activity for the nine months ended September 30, 2017 was as follows:

		Grant-date	
	Shares	fair value	
		(\$ in thousands)	
Non-vested as of December 31, 2016	840,834	\$	6,564
Granted	340,939		3,350
Vested	(384,473)	(3,209	)
Forfeited	(7,333	)	(65
Non-vested as of September 30, 2017	789,967	\$	6,640

The Company's compensation expense related to restricted stock was \$0.9 million and \$2.6 million, respectively, for the three and nine months ended September 30, 2017 and \$1.0 million and \$2.8 million, respectively, for the three and nine months ended September 30, 2016. The unrecognized compensation cost of \$2.9 million at September 30, 2017 is expected to be recognized over the next three years.

## Stock Options

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

Stock option activity for the nine months ended September 30, 2017 was as follows:

	Options
Outstanding as of December 31, 2016	421,692
Granted	—
Exercised	(286,692)
Forfeited	(10,000)
Outstanding as of September 30, 2017	125,000
Vested and exercisable as of September 30, 2017	125,000

As of September 30, 2017 and December 31, 2016, the Company has recognized all compensation costs related to options granted.

Note 10. Earnings Per Share

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

34

---

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

The computations of basic and diluted income per share for the three and nine months ended September 30, 2017 and 2016 are as follows:

	Three Months Ended September 30, 2017		Nine Months Ended September 30, 2016	
	2017	2016	2017	2016
	(In thousands)			
<b>Numerator:</b>				
Net income to common shareholders	\$4,585	\$8,644	\$10,119	\$17,894
Net income allocated to participating securities - basic and diluted	87	157	191	302
Net income allocated to common shareholders - basic and diluted	4,498	8,487	9,928	17,592
<b>Denominator:</b>				
Denominator for basic earnings per common share	40,786	45,812	41,269	46,216
<b>Denominator for diluted earnings per common share:</b>				
Denominator for basic earnings per common share	40,786	45,812	41,269	46,216
Potentially dilutive securities - options	21	—	20	—
Total weighted average diluted shares	40,807	45,812	41,289	46,216
<b>Earnings per common share</b>				
Basic	\$0.11	\$0.19	\$0.24	\$0.38
Diluted	\$0.11	\$0.19	\$0.24	\$0.38

Warrants to purchase 12,000,000 shares of common stock were not included in the computation of earnings per share for the three and nine months ended September 30, 2017 and 2016 due to the fact that the effect would be anti-dilutive. Stock options representing 741,845 shares were not included in the computation of earnings per share for the nine months ended September 30, 2016 due to the fact that the effect would be anti-dilutive.

Note 11. Variable Interest Entities

The Company sponsors the formation of various entities that are considered to be VIEs. The majority of these VIEs were formed to issue term debt securitizations. The assets of the VIEs are primarily comprised of senior secured loans and the liabilities are primarily comprised of debt. The Company's determination of whether it is the primary beneficiary of the VIE is based in part on an assessment of whether or not the Company is exposed to the majority of the risks and rewards of the entity. In instances where the Company retains a significant portion of the equity and remains the servicer of the loans, it was determined that the Company has the power to direct the activities that most significantly impact the economic performance of these VIEs. Additionally, the Company determined that the potential fees that we could receive directly or indirectly from these VIEs represent rights to returns that could potentially be significant to the VIEs. As a result, the Company was deemed the primary beneficiary and therefore has consolidated these entities. Liabilities of the consolidated VIEs are disclosed in Note 7.

Unconsolidated VIEs

In July 2017, NewStar acquired Fifth Street CLO Management LLC, which was rebranded and now operates as NewStar Commercial Loan Originator II LLC, a wholly owned subsidiary of the Company. The purchase included contracts to manage two off balance sheet middle market CLOs, which have been renamed NewStar Exeter Fund CLO LLC (“Exeter Fund”) and NewStar Fairfield Fund CLO LTD (“Fairfield Fund”). The Company holds \$3.9 million of Class F and subordinated notes of Exeter Fund and \$21.5 million (vertical strip) of the notes of Fairfield Fund. Interests in the Fairfield Fund were retained to satisfy EU risk retention rules. The Company has determined that it is not the primary beneficiary of either the Exeter Fund or Fairfield Fund and will not consolidate the operating results or statements of financial position; however, the Company has determined that it has a variable interest in both the Exeter Fund and Fairfield Fund as it holds notes of the securitization.

On April 18, 2017, NewStar refinanced its managed credit fund, Longfellow Place CLO, Ltd. (the “Longfellow Fund”), under a \$516.9 million term debt securitization. The Longfellow Fund is a credit fund established in February 2013 to finance the purchase of a broadly syndicated bank loan portfolio through the issuance of debt and equity. To comply with EU risk retention rules, the Company holds 5% of each class of notes in the securitization (vertical strip), totaling \$27.5 million. The Company has determined that it is not the primary beneficiary of the Longfellow Fund and will not consolidate the Longfellow Fund’s operating results or statements of financial position; however, the Company has determined that it has a variable interest in the Longfellow Fund as it holds notes of the securitization.

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

In November 2016, NewStar closed a new managed credit fund, NewStar Berkeley Fund CLO LLC (the “Berkeley Fund”), a \$505.0 million term debt securitization. The Berkeley Fund is the fourth credit fund established by the Company to co-invest in directly originated middle market commercial loans. To comply with EU risk retention rules, the Company holds 5% of each class of notes in the securitization (vertical strip), totaling \$25.3 million. The Company has determined that it is not the primary beneficiary of the Berkeley Fund and will not consolidate the Berkeley Fund’s operating results or statements of financial position; however, the Company has determined that it has a variable interest in the Berkeley Fund as it holds notes of the securitization.

In January 2015, NewStar closed a new managed credit fund, NewStar Clarendon Fund CLO LLC (the “Clarendon Fund”), a \$400.0 million term debt securitization. The Clarendon Fund is the third credit fund established by the Company to co-invest in directly originated middle market commercial loans. To comply with EU risk retention rules, the Company holds 5% of each class of notes in the securitization (vertical strip), totaling \$20.4 million. The Company has determined that it is not the primary beneficiary of the Clarendon Fund and will not consolidate the Clarendon Fund’s operating results or statements of financial position; however, the Company has determined that it has a variable interest in the Clarendon Fund as it holds notes of the securitization.

In October 2015, NewStar acquired FOC Partners, which now operates as NewStar Capital. At acquisition, NewStar Capital was the investment manager for six collateralized loan obligations and two sponsored funds and provided discretionary services to a series of separately managed accounts. The Company determined that it was not the primary beneficiary of any of acquired CLOs, sponsored funds or separately managed accounts; however, the Company determined that it had a variable interest in the Secured Value sponsored fund as it holds approximately one percent of the interest of the fund. The Secured Value sponsored fund was liquidated on September 29, 2017.

The following table sets forth the information with respect to the unconsolidated VIEs for which the Company holds a variable interest in as of September 30, 2017 and December 31, 2016:

	September 30, 2017	December 31, 2016
	(\$ in thousands)	
Unconsolidated VIE assets	\$2,104,050	\$ 912,900
Unconsolidated VIE liabilities	1,903,200	810,030
Equity interest included on the Consolidated Balance Sheet	103,602	50,386
Maximum risk of loss (1)	105,570	50,794

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

Note 12. Financial Instruments with Off-Balance Sheet Risk

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

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

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

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

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

	September 30, 2017	December 31, 2016
	(\$ in thousands)	
Unused lines of credit	\$303,861	\$ 326,051
Standby letters of credit	6,776	8,239

### Note 13. Total Return Swap

The Company was a participant in a Total Return Swap (“TRS”), which matured on March 31, 2016. We acted as the manager of the TRS and selected the specific loans to be subject to the TRS. The TRS did not qualify for hedge accounting treatment as it did not offset the risks of another investment position.

The underlying referenced loan portfolio of the TRS was primarily large, liquid, broadly syndicated senior secure floating rate loans with Citibank, N.A. as the counterparty. The TRS effectively added leverage to the Company's portfolio by providing economic benefits of the loans subject to the TRS, despite the fact that such loans were not directly owned the Company, in return for an interest-type payment to Citibank.

On December 4, 2014, NewStar TRS I LLC, a newly-formed wholly owned subsidiary of the Company, entered into the TRS. The initial maximum market value (determined at the time such loan becomes subject to the TRS) of the portfolio of loans subject to the TRS was \$75.0 million. On December 15, 2014, we entered into an amendment to the TRS that increased the maximum value to \$125.0 million, on March 2, 2015, we entered into an amendment that increased the maximum value to \$150.0 million, and on July 14, 2015, we entered into an additional amendment to the TRS that increased the maximum value to \$175.0 million.

Upon maturity of the TRS on March 31, 2016, the Company purchased \$138.9 million of the loans in the referenced portfolio. The majority of these loans were purchased to fund future CLOs of the Company and its wholly owned subsidiary NewStar Capital. The Company recorded these loans at fair value which was determined by using the midpoint of the bid-ask spread provided by an independent third-party pricing service.

At March 31, 2016, the receivable and realized loss on the total return swap on the consolidated balance sheet and consolidated statements of operations consisted of the following:

	Net Receivable	Net Realized Gains/(Losses)
	(\$ in thousands)	
Interest income from TRS portfolio	\$—	\$ 2,355
TRS interest expense	—	848
Realized loss on TRS	—	(6,122)
Due to Citibank	(10,984)	—
TRS receivable	1,145	—

The fair value of the TRS was reflected as an unrealized gain or loss on the total return swap on the consolidated balance sheet, within other assets or liabilities. The change in value of the TRS was reflected in the consolidated statements of operations as loss on total return swap.

The Company's obligations under the TRS were non-recourse to it, and its exposure was limited to the value of the cash collateral which fluctuated from time to time depending on the market value of the underlying loans. The Company was required to cash collateralize a specified percentage of each loan included under the TRS in accordance with margin requirements. As of September 30, 2017 and December 31, 2016, the Company had no cash collateral on deposit with Citibank.

The Company paid interest to Citibank for each loan at a rate equal to one-month LIBOR plus 1.60% per annum. Upon the termination or repayment of any loan under the TRS Agreement, the Company would deduct the appreciation of such loan's value from any interest owed to Citibank or pay the depreciation amount to Citibank in addition to remaining interest payments.

#### Note 14. Fair Value

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

Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument’s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

#### Items Recorded at Fair Value on a Recurring Basis

##### Investments in debt securities, available-for-sale

Investments in debt securities available-for-sale are recorded at fair value on a recurring basis. The fair value measurement of investments in debt securities is based on third party pricing services or by using internally developed financial models. For securities in less liquid markets where there is limited activity and little transparency around broker quotes used to value such securities, the Company classifies securities valued using broker quotes as Level 3. If quoted prices are not available, then fair value is estimated by using internally developed financial models. These securities are not actively traded and require a private sale, and the valuation involves application of significant management judgment. Inputs into the model-based valuations can include changes in market indexes, selling prices of similar securities, management’s assumptions related to the credit rating of the security, prepayment assumptions and other factors such as credit loss assumptions and management’s assessment of the current market conditions. Such securities are classified as Level 3, as the valuation models are based on significant inputs that are unobservable in the market.

##### Loans

Loans designated to credit funds managed by NewStar Capital are recorded at fair value on a recurring basis. The Company has elected to apply fair value option accounting to these loans which is consistent with the manner in which the credit funds are managed. The fair value of these loans is based on third party pricing services. These loans are classified as Level 2. During the three months and nine months ended September 30, 2017, the Company recorded \$0.9 million and \$6.8 million, respectively, of losses from the change in fair value.

#### Items Measured at Fair Value on a Nonrecurring Basis

##### Collateral dependent impaired loans

Collateral dependent loans that are deemed to be impaired are valued based upon the fair value of the underlying collateral. For collateral dependent loans for which repayment is dependent on the sale of the collateral, management adjusts the fair value for estimated costs to sell. For collateral dependent loans for which repayment is dependent on the operation of the collateral, management may also adjust values to reflect estimated market value declines or apply other discounts to appraised values. Collateral dependent impaired loans are categorized as Level 3. During the nine months ended September 30, 2017, the Company did not record any specific allowance for credit losses related to “Collateral dependent impaired loans” measured at fair value. During 2016, the Company recorded \$4.3 million of specific allowance for credit losses related to “Collateral dependent impaired loans” measured at fair value at

December 31, 2016, of which \$4.2 million was subsequently charged off when the impaired loans were transferred to the held-for-sale portfolio.

#### Loans held-for-sale

Loans held-for-sale are carried at the lower of cost or fair value. Loans held-for-sale measured at fair value consist of loans that have had credit downgrades and/or have remained in the loans held-for-sale portfolio for a significant period of time. When fair value is determined to be the carrying value, the fair values of these loans are obtained through a third party pricing service or by using internally developed financial models. Inputs into the model-based valuations can include changes in market indexes, selling prices of similar loans, management's assumption related to the credit rating of the loan, prepayment assumptions and other factors, such as credit loss assumptions. Where quoted market prices are obtained through dealer quotes, broker indicative prices or online posts, loans

38

---

held-for-sale are classified as Level 2. Loans held-for-sale are classified as Level 3 in instances where valuation models are based on significant inputs that are unobservable in the market. During the three months and nine months ended September 30, 2017, the Company recorded a loss of \$0.5 million and a loss of \$0.6 million, respectively, related to “Loans, held-for-sale” measured at fair value. During 2016, the Company recorded a \$2.4 million gain related to “Loans, held-for-sale” measured at fair value.

Other real estate owned or repossessed assets

The fair value is estimated using one of several methods, including collateral value, market value of similar properties, liquidation value and discounted cash flows. Management may adjust the fair value for estimated costs to sell or adjust values to reflect estimated market value declines or apply other discounts to values. The Company records the other real estate owned and repossessed assets as Level 3. During the nine months ended September 30, 2017, the Company recorded a \$0.1 million expense to write down repossessed assets owned to fair value. During 2016, the Company recorded a \$0.3 million expense to write down other real estate owned to fair value.

The following table presents recorded amounts of assets and liabilities measured at fair value on a recurring and nonrecurring basis as of September 30, 2017, by caption in the consolidated balance sheet and by ASC 820 valuation hierarchy.

	Quoted Prices			Total
	in Active Markets for Other	Significant Markets for Other	Significant Unobservable Inputs (Level 3)	Carrying Value in Consolidated Balance Sheet
	Identifiable Assets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	
	(\$ in thousands)			
<b>Recurring Basis:</b>				
Assets:				
Investments in debt securities, available-for-sale	\$—	\$ —	\$ 175,837	\$ 175,837
Loans	—	407,465	—	407,465
<b>Total assets recorded at fair value on a recurring basis</b>	<b>\$—</b>	<b>\$ 407,465</b>	<b>\$ 175,837</b>	<b>\$ 583,302</b>
<b>Nonrecurring Basis:</b>				
Assets:				
Loans held-for-sale	\$—	\$ 25,219	\$ 10,538	\$ 35,757
Other real estate owned/repossessed assets	—	—	15,600	15,600
<b>Total assets recorded at fair value on a</b>				
nonrecurring basis	\$—	\$ 25,219	\$ 26,138	\$ 51,357

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

The following table presents recorded amounts of assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2016, by caption in the consolidated balance sheet and by ASC 820 valuation hierarchy.

	Quoted Prices	Other Significant Observable Inputs (Level 1) (Level 2)	Significant Unobservable Inputs (Level 3)	Total Carrying Value in Consolidated Balance Sheet
	Markets for Identical Assets (Level 1)	for		
	(\$ in thousands)			
<b>Recurring Basis:</b>				
<b>Assets:</b>				
Investments in debt securities, available-for-sale	\$—	\$ —	\$ 119,307	\$ 119,307
Loans	—	403,745	—	403,745
<b>Total assets recorded at fair value on a recurring basis</b>	<b>\$—</b>	<b>\$ 403,745</b>	<b>\$ 119,307</b>	<b>\$ 523,052</b>
<b>Liabilities:</b>				
Contingent liability	—	—	1,350	\$ 1,350
<b>Total liabilities recorded at fair value on a recurring basis</b>	<b>\$—</b>	<b>\$ —</b>	<b>\$ 1,350</b>	<b>\$ 1,350</b>
<b>Nonrecurring Basis:</b>				
<b>Assets:</b>				
Loans held-for-sale	\$—	\$ 4,465	\$ 2,459	\$ 6,924
Other real estate owned/repossessed assets	—	—	15,750	15,750
<b>Total assets recorded at fair value on a nonrecurring basis</b>	<b>\$—</b>	<b>\$ 4,465</b>	<b>\$ 18,209</b>	<b>\$ 22,674</b>

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

The following table presents a summary of significant unobservable inputs and valuation techniques of the Company's Level 3 fair value measurements at September 30, 2017.

	Fair value	Valuation Techniques	Unobservable Input	Range
	(\$ in thousands)			
<b>Financial assets:</b>				
Investments in debt securities, available-for-sale	\$175,837	Third-party pricing	Pricing assumptions such as prepayment rates, interest rates, loss assumptions, cash flow projections, and comparisons to similar financial instruments	
Loans held-for-sale	10,538	Market comparables	Cost to Sell	3%-7%
		Valuation model	Marketability discount	5%-30%
Other real estate/repossessed assets	15,600	Appraisal	Cost to sell	3%- 7%
<b>Total Assets:</b>	<b>\$201,975</b>			

The following table presents a summary of significant unobservable inputs and valuation techniques of the Company's Level 3 fair value measurements at December 31, 2016.

	Fair value	Valuation Techniques	Unobservable Input	Range
	(\$ in thousands)			
<b>Financial assets:</b>				
Investments in debt securities, available-for-sale	\$119,307	Third-party pricing	Pricing assumptions such as prepayment rates, interest rates, loss assumptions, cash flow projections, and comparisons to similar financial instruments	
Loans held-for-sale	2,459	Market comparables	Cost to sell	3% - 7%
		Valuation model	Marketability discount	5%-30%
Other real estate owned/repossessed assets	15,750	Appraisal	Cost to sell	3% - 7%
<b>Total Assets:</b>	<b>\$137,516</b>			
<b>Financial liabilities:</b>				
Contingent liability	1,350	Valuation model	PoD/LGD	
<b>Total Liability:</b>	<b>\$1,350</b>			

Changes in Level 3 recurring fair value measurements

The table below illustrates the change in balance sheet amounts during the three and nine months ended September 30, 2017 and 2016 (including the change in fair value), for financial instruments measured on a recurring basis and classified by the Company as Level 3 in the valuation hierarchy. When a determination is made to classify a financial instrument as Level 3, the determination is based upon the significance of the unobservable parameters to the overall fair value measurement. However, Level 3 financial instruments typically include, in addition to the unobservable or

Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources); accordingly, the gains and losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology. The Company did not transfer any financial instruments in or out of Level 1, 2, or 3 during the three and nine months ended September 30, 2017 and 2016. As of June 30, 2017 it was determined that the contingent liability was no longer measured at fair value.

40

---

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

For the three months ended September 30, 2017:

	Investments in Debt Securities, Available-for-sale (\$ in thousands)
Balance as of June 30, 2017	\$ 151,426
Total gains or losses (realized/unrealized)	
Included in earnings	161
Included in other comprehensive income (loss)	1,488
Purchases	23,069
Issuances	—
Settlements	(307 )
Balance as of September 30, 2017	\$ 175,837

For the three months ended September 30, 2016:

	Investments in Debt Securities, Available-for-sale (\$ in thousands)
Balance as of June 30, 2016	\$ 91,400
Total gains or losses (realized/unrealized)	
Included in earnings	342
Included in other comprehensive income (loss)	5,072
Purchases	—
Issuances	—
Settlements	(6,000 )
Balance as of September 30, 2016	\$ 90,814

For the nine months ended September 30, 2017:

	Investments in Debt Securities, Available-for-sale (\$ in thousands)
Balance as of December 31, 2016	\$ 119,307

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

Total gains or losses (realized/unrealized)	
Included in earnings	539
Included in other comprehensive income (loss)	9,535
Purchases	52,682
Issuances	—
Settlements	(6,226 )
Balance as of September 30, 2017	\$ 175,837

41

---

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

For the nine months ended September 30, 2016:

	Investments in Debt Securities, Available-for-sale (\$ in thousands)
Balance as of December 31, 2015	\$ 94,177
Total gains or losses (realized/unrealized)	
Included in earnings	655
Included in other comprehensive income (loss)	1,982
Purchases	—
Issuances	—
Settlements	(6,000 )
Balance as of September 30, 2016	\$ 90,814

The following table presents the carrying amounts, estimated fair values and placement in the fair value hierarchy of the Company's financial instruments at September 30, 2017 and December 31, 2016. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties.

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

Estimated Fair Value of Financial Instruments  
September 30, 2017

	Carrying		Fair Value Measurements		
	amount	Fair value	Level 1	Level 2	Level 3
	(\$ in thousands)				
<b>Financial assets:</b>					
Investments in debt securities available-for-sale	175,837	175,837			175,837
Loans held-for-sale, net	371,941	376,833		196,977	179,856
Loans, net	2,995,997	2,995,619		407,465	2,588,154
Other assets	20,383	20,383			20,383
<b>Financial liabilities:</b>					
Credit facilities, net	\$456,961	\$456,961		\$456,961	
Term debt, net	16,973	16,973		16,973	
Term debt securitizations, net	2,085,733	2,162,702		2,162,702	
Senior notes, net	375,287	390,450		390,450	
Subordinated notes, net	246,929	325,001			325,001
Repurchase agreements, net	80,569	80,569		80,569	
Other liabilities	1,000	1,000		1,000	

Estimated Fair Value of Financial Instruments  
December 31, 2016

Fair Value Measurements

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

Carrying

	amount	Fair value	Level 1	Level 2	Level 3
	(\$ in thousands)				
Financial assets:					
Investments in debt securities available-for-sale	119,307	119,307			119,307
Loans held-for-sale, net	144,060	145,406		69,875	75,531
Loans, net	3,239,191	3,241,910		403,745	2,838,165
Other assets	15,954	15,954			15,954
Financial liabilities:					
Credit facilities, net	\$445,493	\$445,493		\$445,493	
Term debt securitizations, net	2,195,064	2,230,102		2,230,102	
Senior notes, net	373,919	380,000		380,000	
Subordinated notes, net	241,390	303,916			303,916
Repurchase agreements, net	55,046	55,046		55,046	
Other liabilities	1,350	1,350			1,350

42

### Valuation of Other Financial Instruments

The methodologies for estimating the fair value of financial instruments that are measured at fair value on a recurring or nonrecurring basis are discussed above. The methodologies for other financial instruments are discussed below.

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

**Term debt, net:** The fair value of the term debt is estimated to approximate the carrying value. Rates currently are comparable to those offered to the Company for similar debt instruments of comparable maturities by the Company's lenders.

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

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

**Senior notes, net:** The fair value was based on available quoted market prices.

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

**Other assets/other liabilities:** Comprised of non-public investments carried within other assets at \$20.4 million and \$16.0 million, as of September 30, 2017 and December 31, 2016, respectively. These investments are in the form of equity or warrants and are obtained as part of the loan origination process. The investments are initially recorded at cost and reviewed quarterly. If the fair value is less than cost then the investment is written down to fair value with the necessary adjustment recorded through current earnings. Fair value is determined using internally developed valuation models. Where sufficient data exists, a market approach method is utilized to estimate the current value of the underlying company. The estimated fair value of the underlying securities for warrants requiring valuation at fair value is adjusted for discounts related to lack of liquidity. The Company classifies equity and warrants as Level 3. The contingent liability for potential indemnification obligations from the sale of Equipment Finance was included in other liabilities as of September 30, 2017 and December 31, 2016. Its fair value was based on periodic portfolio review and various assumptions used by management. The Company classifies the contingent liability as Level 3.

### Note 15. Segment Reporting

Beginning in 2016, the Company has two reportable segments, Commercial Lending and Asset Management. Segment information is derived from the internal reporting system utilized by management. Revenues and expenses for segments reflect those revenue and expenses which can be specifically identified and have been assigned based on internally developed allocation methods. Results may be restated, when necessary, to reflect changes in organizational structure or allocation methodology. Any changes in allocations that may affect the reported results of any business segment will not affect the consolidated financial position or results of operations of the Company as a whole.

## Commercial Lending

The Commercial Lending segment represents our direct lending activities which are focused on providing a range of flexible senior secured debt options to mid-sized companies with annual cash flow (EBITDA) typically between \$15 million and \$50 million owned by private equity investment funds and managed by established professional alternative asset managers. The size of financing commitments depends on various factors, including the type of loan, the credit characteristics of the borrower, the economic characteristics of the loan, and the Company's role in the transaction. The Company may retain these loans on its balance sheet or allocate these loans to off balance sheet managed credit funds managed by the Company or other lenders. By allocating these loans to the Company's off balance sheet managed credit funds and other lenders, it is able to provide larger financing commitments to its customers and generate fee income, while limiting its risk exposure to single borrowers.

## Asset Management

The Asset Management segment represents our investment advisory activities which include credit funds managed by the Company and NewStar Capital. Credit funds managed by the Company focus on co-invest middle market loans originated through

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

our leveraged finance lending platform, liquid tradeable credit and liquid loan strategies. NewStar Capital manages assets across a series of CLOs that invest primarily in broadly syndicated loans, as well as other sponsored funds and managed accounts that invest across various liquid, non-investment grade asset classes, including broadly syndicated loans and bonds.

The following tables presents the statement of operations and total assets for the Company's reportable segments:

	Three Months Ended September 30, 2017		
	Commercial	Asset	Consolidated
	Lending	Management	Total
Net interest income:	\$ 14,495	\$ 1,112	\$ 15,607
Provision for loan losses	1,494	—	1,494
Net interest income after provision	13,001	1,112	14,113
Noninterest income:			
Management fees	—	3,474	3,474
Performance fees	—	70	70
Other lending fees	988	37	1,025
Gain on sale of loans and equipment	27	247	274
Other noninterest income (1)	1,837	(1,157 )	680
Total noninterest income:	2,852	2,671	5,523
Non-interest expense	9,371	2,529	11,900
Income before income taxes	\$ 6,482	\$ 1,254	\$ 7,736
Income tax expense			3,151
Net income			\$ 4,585

(1) Includes fair value adjustments on Loans held-for-sale and fair value portfolio.

	Nine Months Ended September 30, 2017		
	Commercial	Asset	Consolidated
	Lending	Management	Total
Net interest income:	\$ 41,136	\$ 3,467	\$ 44,603
Provision for loan losses	10,341	—	10,341
Net interest income after provision	30,795	3,467	34,262
Noninterest income:			
Management fees	—	9,602	9,602
Performance fees	—	1,415	1,415
Other lending fees	6,257	122	6,379
Gain on sale of loans and equipment	246	1,235	1,481
Other noninterest income (1)	5,146	(7,170 )	(2,024 )
Total noninterest income:	11,649	5,204	16,853
Non-interest expense	27,229	6,607	33,836
Income before income taxes	\$ 15,215	\$ 2,064	\$ 17,279
Income tax expense			7,160

Net income	\$ 10,119
------------	-----------

(1)Includes fair value adjustments on Loans held-for-sale and fair value portfolio.

44

---

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

	Three months ended September 30, 2016		
	Commercial	Asset	Consolidated
	Lending	Management	Total
	(\$ in thousands)		
Net interest income	\$24,135	\$ 1,123	\$ 25,258
Provision for loan losses	3,570	—	3,570
Net interest income after provision	20,565	1,123	21,688
Noninterest income:			
Management fees	—	2,888	2,888
Performance fees	—	465	465
Other lending fees	2,871	75	2,946
Gain on sale of loans and equipment	83	69	152
Other noninterest income (1)	1,059	3,456	4,515
Total Noninterest income:	4,013	6,953	10,966
Non-interest expense	14,833	3,236	18,069
Income before income taxes	\$9,745	\$ 4,840	\$ 14,585
Income tax expense			5,941
Net income			\$ 8,644

(1) Includes fair value adjustment on Loans held-for-sale.

	Nine months ended September 30, 2016		
	Commercial	Asset	Consolidated
	Lending	Management	Total
	(\$ in thousands)		
Net interest income	\$65,752	\$ 2,931	\$ 68,683
Provision for loan losses	24,906	—	24,906
Net interest income after provision	40,846	2,931	43,777
Noninterest income:			
Management fees	—	9,031	9,031
Performance fees	—	1,306	1,306
Other lending fees	5,729	107	5,836
Gain on sale of loans and equipment	545	220	765
Other noninterest income (1)	13,819	3,720	17,539
Total Noninterest income:	20,093	14,384	34,477
Non-interest expense	40,027	7,950	47,977
Income before income taxes	\$20,912	\$ 9,365	\$ 30,277
Income tax expense			12,383
Net income			\$ 17,894

(1) Includes fair value adjustments on Loans held-for-sale and fair value portfolio.



September 30, 2017	Commercial Asset		
	Lending	Management	Total
	(\$ in thousands)		
Loans and leases, gross (including loans at fair value of \$407,465)	\$2,652,825	\$ 407,465	\$3,060,290
Loans held-for-sale, gross	375,560	—	375,560
Investments in debt securities, available-for-sale	—	175,837	175,837
Other	314,780	76,167	390,947
Total Balance Sheet Assets	3,343,165	659,469	4,002,634
Illiquid Credit funds *	—	2,018,397	2,018,397
Liquid/Tradeable Credit *	—	1,541,582	1,541,582
Total Assets	3,343,165	4,219,448	7,562,613
Less: Non Managed assets (1)	314,780	66,193	380,973
Total Managed Assets	\$3,028,385	\$ 4,153,255	\$7,181,640

\* Assets managed by the Company for the Illiquid Credit and Liquid/Tradeable Credit Funds are not assets of the Company and are not included in the Consolidated Total Assets as reflected in the Condensed Consolidated Balance Sheet.

(1) Other less unamortized discount on investment in debt securities, available-for-sale.

December 31, 2016	Commercial Asset		
	Lending	Management	Total
	(\$ in thousands)		
Loans and leases, gross (including loans at fair value of \$403,745)	\$2,915,805	\$ 403,745	\$3,319,550
Loans held-for-sale, gross	145,966	—	145,966
Investments in debt securities, available-for-sale	—	119,307	119,307
Other	374,851	80,918	455,769
Total Balance Sheet Assets	3,436,622	603,970	4,040,592
Illiquid Credit funds *	—	1,314,690	1,314,690
Liquid/Tradeable Credit *	—	1,833,607	1,833,607
Total Assets	3,436,622	3,752,267	7,188,889
Less: Non Managed assets (1)	374,851	74,175	449,026
Total Managed Assets	\$3,061,771	\$ 3,678,092	\$6,739,863

\* Assets managed by the Company for the Illiquid Credit and Liquid/Tradeable Credit Funds are not assets of the Company and are not included in the Consolidated Total Assets as reflected in the Condensed Consolidated Balance Sheet.

(1) Other less unamortized discount on investment in debt securities, available-for-sale.

Note 16. Related-Party Transactions

Pursuant to an Investment Management Agreement dated August 3, 2005, the Company serves as investment manager of the NewStar Credit Opportunities Fund, Ltd., a Cayman Islands exempted company limited by shares incorporated under the provisions of The Companies Law of the Cayman Islands. This Fund pays the Company a fee when cash is distributed to its investors. For the three and nine months ended September 30, 2017, the fund paid the Company \$0.01 million, and for the three and nine months ended September 30, 2016, the Fund paid the Company zero and \$0.01 million, respectively.

Pursuant to a Collateral Management Agreement dated June 26, 2014, the Company serves as collateral manager of the Arlington Program. The Company is entitled to receive a fee, which will accrue quarterly based on the fee basis amount in arrears payable on each payment date. For the three and nine months ended September 30, 2017 the Arlington Program's collateral management fee was \$0.5 million and \$1.5 million, respectively and for the three and nine months ended September 30, 2016, the Arlington Program's collateral management fee was \$0.5 million and \$1.5 million, respectively.

On January 15, 2015, the Company closed the NewStar Clarendon Fund CLO LLC (the “Clarendon Fund”), a \$400.0 million term debt securitization. The Clarendon Fund is the third credit fund established by the Company to co-invest in directly originated middle market commercial loans. To comply with EU risk retention rules, the Company holds 5% of each class of note in the securitization, totaling \$20.4 million. The Clarendon Fund employs an independent investment professional who is responsible for reviewing and approving investment recommendations made to the Clarendon Fund by the Company. The Company has determined that it is not the primary beneficiary of the Clarendon Fund and will not consolidate the Clarendon Fund’s operating results or statements of financial position. Pursuant to a Collateral Management Agreement dated January 15, 2015, the Company serves as collateral manager of the Clarendon Fund. The Company is entitled to receive a fee, which will accrue quarterly based on the fee basis amount in arrears payable on each payment date. For the three and nine months ended September 30, 2017, the Clarendon Fund’s collateral management fee was \$0.5 million and \$1.5 million, respectively and for the three and nine months ended September 30, 2016, the Clarendon Fund’s collateral management fee was \$0.5 million and \$1.5 million, respectively.

On November 29, 2016, the Company closed the Berkeley Fund, a \$505.0 million term debt securitization. The Berkeley Fund is the fourth credit fund established by the Company to co-invest in directly originated middle market commercial loans. To comply with EU risk retention rules, the Company holds 5% of each class of note in the securitization, totaling \$25.3 million. The Berkeley Fund employs an independent investment professional who is responsible for investment decision making on behalf of the program. The Company has determined that it is not the primary beneficiary of the Berkeley Fund and will not consolidate the Berkeley Fund’s operating results or statements of financial position. Pursuant to a Collateral Management Agreement dated November 29, 2016, the Company serves as collateral manager of the Berkeley Fund. The Company is entitled to receive a fee, which will accrue quarterly based on the fee basis amount in arrears payable on each payment date. For the three and nine months ended September 30, 2017, the Berkeley Fund’s collateral management fee was \$0.5 million and \$1.6 million, respectively.

On April 18, 2017, the Company refinanced its managed credit fund, Longfellow Place CLO Ltd. (the “Longfellow Fund”), under a \$516.9 million term debt securitization. The Longfellow fund is a credit fund established in February 2013 to finance the purchase of a broadly syndicated bank loan portfolio through the issuance of debt and equity. To comply with EU risk retention rules, the Company holds 5% of each class of note in the securitization, totaling \$27.5 million. The Company has determined that it is not the primary beneficiary of the Longfellow Fund and will not consolidate the Longfellow Fund’s operating results or statements of financial position. Pursuant to a Collateral Management Agreement dated January 15, 2015, the Company serves as collateral manager of the Longfellow Fund. The Company is entitled to receive a fee, which will accrue quarterly based on the fee basis amount in arrears payable on each payment date. For the three and nine months ended September 30, 2017, the Longfellow Fund’s collateral management fee was \$0.4 million and \$1.1 million, respectively.

On July 20, 2017, the Company acquired contracts to manage two off balance sheet middle market CLOs, which have been renamed to the Exeter Fund and Fairfield Fund, from FSCM. The Company also acquired \$3.9 million of Class F and subordinated notes of the Exeter Fund and approximately 5% of each asset class of notes totaling \$21.5 million of the Fairfield Fund. Interests in the Fairfield Fund were retained to comply with EU risk retention rules. The Company has determined that it is not the primary beneficiary of either the Exeter or Fairfield Fund and will not consolidate the operating results or statements of financial position. Pursuant to Collateral Management Agreements dated February 19, 2015 and September 29, 2015, respectively the Company serves as collateral manager of the Exeter and Fairfield Fund. The Company is entitled to receive a fee, which will accrue quarterly based on the fee basis amount in arrears payable on each payment date. For the three and nine months ended September 30, 2017, the Exeter Fund’s collateral management fee was \$0.2 million. For the three and nine months ended September 30, 2017, the Fairfield Fund’s collateral management fee was \$0.3 million.

Note 17. Subsequent Events

On October 16, 2017, the Company entered into an Agreement and Plan of Merger (the “Merger Agreement”) with First Eagle Holdings, Inc. (“First Eagle”), FE Holdco, LLC, a wholly-owned subsidiary of First Eagle (“FE Holdco”), and a newly formed wholly-owned merger subsidiary of FE Holdco, pursuant to which the merger subsidiary will be merged with and into the Company, with the Company surviving the merger as a wholly-owned subsidiary of FE Holdco. Subject to the terms and conditions set forth in the Merger Agreement, stockholders are expected to receive \$11.44 in upfront cash and one non-transferable contingent value right (CVR) for each share of Company common stock held at closing of the transaction. Each CVR will entitle its holder to receive pro-rata distributions of any tax refunds received by the Company following the closing as a result of a carryback of the Company’s losses generated primarily from the sale of assets to the Asset Buyer (as defined below). The Company estimates these refunds to total \$1.00 per share if the transaction closes in 2017, or \$0.88 per share if the transaction closes in 2018. In a related transaction, NewStar has entered into a definitive agreement (the “Asset Purchase Agreement”) to sell a portfolio of investment assets, including approximately \$2.4 billion of middle-market loans and other credit investments, to a newly formed investment fund sponsored by GSO Capital Partners LP, the global credit investment platform of Blackstone Group L.P. (the “Asset Buyer”). The closing of First Eagle’s acquisition of NewStar is conditioned upon, and will occur immediately following, the Asset Buyer’s completion of the acquisition of such assets. In addition to the closing of the asset sale, completion of the merger is subject to certain additional conditions, including the receipt of the necessary approval of the Company’s stockholders, the satisfaction of certain regulatory approvals and specified

client consents, and other customary closing conditions. In addition to stockholder approval, completion of the asset sale is subject to the satisfaction of the conditions precedent to closing under the definitive merger agreement, the satisfaction of certain regulatory approvals and other customary closing conditions.

On November 1, 2017, our Board of Directors declared a dividend of \$0.02 per share, to be paid on December 15, 2017 to stockholders of record on November 29, 2017.

2012-1 CLO. On October 20, 2017, we called the 2012-2 CLO Trust and redeemed the notes at par. In conjunction with the redemption, we received a cash principal distribution of \$22.6 million.

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

The following discussion contains forward-looking statements. Important factors that may cause actual results and circumstances to differ materially from those described in such statements are described in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016, [as supplemented by the risks outline under Part II, Item 1A of this Quarterly Report on Form 10-Q,] as well as throughout this Item 2. You are cautioned not to place undue reliance on the forward-looking statements contained in this document. These statements speak only as of the date of this document, and we undertake no obligation to update or revise these statements, except as may be required by law.

Overview

NewStar Financial, Inc. (which is referred to throughout this Quarterly Report as "NewStar", "the Company", "we" and "us") is an internally-managed, middle market direct lender and credit-oriented asset manager headquartered in Boston, MA. The Company's direct lending activities are focused on meeting the complex financing needs of companies and private investors in the middle market by offering a range of flexible debt financing options. The Company also offers a range of investment management products employing credit-oriented strategies focused on middle market loans and liquid, tradeable credit. The Company manages approximately \$7.2 billion of assets, \$3.6 billion held in consolidated subsidiaries of the Company and \$3.6 billion in off balance sheet credit funds. The Company continues to transition from an on balance sheet commercial lender towards an asset manager for third parties, as a result the growth is primarily focused on off-balance sheet managed funds.

Below is a summary of where our Assets Under Management ("AUM") are held as of September 30, 2017.

NewStar operates its business through two reportable segments: Commercial Lending and Asset Management.

Commercial Lending

We believe our commercial lending activities require specialized skills and transaction experience, as well as a significant investment in personnel and operating infrastructure. To meet these demands, our loans are originated directly by teams of credit-trained bankers. These teams are supported by centralized credit management and operating platforms. This structure enables us to leverage common standards, systems, and industry and professional expertise across multiple businesses.

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

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

and capital structures, which we believe benefits our credit performance.

The size of financing commitments depends on various factors, including the type of loan, the credit characteristics of the borrower, the economic characteristics of the loan, and our role in the transaction. We also selectively arrange larger transactions that we may retain on our balance sheet or syndicate to other lenders, which include off balance sheet managed credit funds managed for third party institutional investors. By syndicating loans to other lenders and the Company's off balance sheet managed credit funds, we

49

---

are able to provide larger financing commitments to our customers and generate fee income, while limiting our risk exposure to single borrowers.

### Asset Management

As a registered investment adviser, NewStar offers a range of investment products employing credit-oriented strategies focused on middle market loans and liquid tradeable credit. The Company manages a series of private credit funds that co-invest in middle market loans originated through its established leveraged finance lending platform. Through its registered investment adviser subsidiary, NewStar Capital, the Company also manages assets across a series of CLOs that invest primarily in broadly syndicated loans, as well as other sponsored funds and managed accounts that invest across various liquid, non-investment grade asset classes, including broadly syndicated loans and bonds.

### Recent Developments

On October 16, 2017, the Company entered into an Agreement and Plan of Merger (the “Merger Agreement”) with First Eagle Holdings, Inc. (“First Eagle”), FE Holdco, LLC, a wholly-owned subsidiary of First Eagle (“FE Holdco”), and a newly formed wholly-owned merger subsidiary of FE Holdco, pursuant to which the merger subsidiary will be merged with and into the Company, with the Company surviving the merger as a wholly-owned subsidiary of FE Holdco. Subject to the terms and conditions set forth in the Merger Agreement, stockholders are expected to receive \$11.44 in upfront cash and one non-transferable contingent value right (CVR) for each share of Company common stock held at closing of the transaction. Each CVR will entitle its holder to receive pro-rata distributions of any tax refunds received by the Company following the closing as a result of a carryback of the Company’s losses generated primarily from the sale of assets to the Asset Buyer (as defined below). The Company estimates these refunds to total \$1.00 per share if the transaction closes in 2017, or \$0.88 per share if the transaction closes in 2018. In a related transaction, NewStar has entered into a definitive agreement (the “Asset Purchase Agreement”) to sell a portfolio of investment assets, including approximately \$2.4 billion of middle-market loans and other credit investments, to a newly formed investment fund sponsored by GSO Capital Partners LP, the global credit investment platform of Blackstone Group L.P. (the “Asset Buyer”). The closing of First Eagle’s acquisition of NewStar is conditioned upon, and will occur immediately following, the Asset Buyer’s completion of the acquisition of such assets. In addition to the closing of the asset sale, completion of the merger is subject to certain additional conditions, including the receipt of the necessary approval of the Company’s stockholders, the satisfaction of certain regulatory approvals and specified client consents, and other customary closing conditions. In addition to stockholder approval, completion of the asset sale is subject to the satisfaction of the conditions precedent to closing under the definitive merger agreement, the satisfaction of certain regulatory approvals and other customary closing conditions.

On November 1, 2017, our Board of Directors declared a dividend of \$0.02 per share, to be paid on December 15, 2017 to stockholders of record on November 29, 2017.

2012-1 CLO. On October 20, 2017, we called the 2012-2 CLO Trust and redeemed the notes at par. In conjunction with the call, we received a principal distribution of \$22.6 million.

### Market Conditions

Market conditions in our primary target loan market tightened in the third quarter of 2017 as middle market loan volume and pricing decreased versus last quarter. According to Thomson Reuters, overall middle market loan volume in the third quarter was \$31.8 billion versus \$45.4 billion last quarter (revised upward) and versus \$35.8 billion in the same period last year. The volume represented by new middle market transactions, as opposed to refinancing transactions, decreased in the third quarter to \$15.9 billion from \$19.9 billion in the prior quarter and versus \$18.9 billion in the same quarter last year. Refinancing volume also decreased in the third quarter of 2017 to \$14.9 billion from \$19.9 billion in the prior quarter, and versus \$16.9 billion in the same quarter last year. As a percentage of total

middle market volume, new transactions increased slightly in the third quarter to 52% versus 50% last quarter, but decreased slightly versus 53% in the same period last year.

The pricing environment in our primary target market tightened in the third quarter as middle market loan yields were down to 6.0% from 6.2% last quarter and down from 6.7% in the same quarter last year. Middle market loan yields continue to exhibit a premium versus large corporate loans although yields in the large corporate market widened to 5.0% in the third quarter from 4.8% last quarter, but tightened versus 5.2% in the same quarter last year.

Our direct lending platforms provide us with certain flexibility to allocate capital and redirect our origination focus to market segments with the most favorable conditions in terms of demand and relative value. We believe that the yields on our new loan origination will continue to reflect a combination of these broad market trends and shifts in the mix of loans we originate.

50

---

Conditions in our core funding markets have improved in 2017 and continued to improve through the third quarter. We believe conditions will continue to improve throughout the year as comfort grows with regulatory issues and investors continue to favor high-yielding, shorter duration floating rate bank loans and CLO bonds over fixed rate debt.

Total U.S. CLO year-to-date issuance through the third quarter of \$82.0 billion represents a significant increase relative to \$46.0 billion in the same period last year. For reference, total U.S. CLO issuance in 2016, 2015 and 2014 was approximately \$72.0 billion, \$99.0 billion and \$124.0 billion, respectively. Along with the increasing momentum in CLO issuance, CLO credit spreads tightened throughout 2017, a trend we anticipate will continue through the year as market conditions remain supportive for experienced managers such as NewStar to issue new CLOs. We also believe the availability and cost of warehouse financing among banks remains accommodative as an increasing number of banks are providing this type of financing and existing providers are expanding their lending activity. As a result, we believe that the terms and conditions for financings available to established firms like NewStar will continue to be supportive.

Loan demand in the middle market is strongly influenced by the level of refinancing, acquisition activity and private investment, which is driven largely by changes in the perceived risk environment, prevailing borrowing rates and private investment activity. These factors were generally favorable as we originated \$317 million of new loans at attractive yields in the third quarter. With attractive pricing, leverage below the broader loan market, and equity contributions higher than the broader market, conditions in our primary target markets continue to remain favorable. We anticipate that demand for loans and leases offered by the Company and conditions in our lending markets will remain supportive through 2017 and continue to provide opportunities for us to increase our origination volume

#### RESULTS OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016

NewStar's basic and diluted income per share for the three months ended September 30, 2017 was \$0.11, on net income of \$4.6 million. Our basic and diluted income per share was \$0.24 for the nine months ended September 30, 2017 on net income of \$10.1 million. This compares to basic and diluted income per share for the three months ended September 30, 2016 of \$0.19, on net income of \$8.6 million and basic and diluted income per share for the nine months ended September 30, 2016 of \$0.38 on net income of \$17.9 million. Our managed portfolio was \$7.2 billion at September 30, 2017 compared to \$6.7 billion at December 31, 2016.

#### Loan portfolio yield

Loan portfolio yield, which is interest income on our loans divided by the average balances outstanding of our loans and leases, was 6.44% and 6.38% for the three and nine months ended September 30, 2017 and 6.77% and 6.38%, for the three and nine months ended September 30, 2016, respectively. The loan portfolio yield in the three months ended September 30, 2017 decreased from the same period in the prior year, primarily related to a pay-off of a nonperforming loan at par on which we recognized \$3.2 million of interest income during the third quarter of 2016. The loan portfolio yield in the nine months ended September 30, 2017 was consistent with the prior year. It was positively impacted during the period by increasing LIBOR rates and the sale of Equipment Finance and Business Credit, which was partially offset by an increase in the volume of our broadly syndicated loans which are lower yielding.

#### Net interest margin

Net interest margin, which is net interest income divided by average interest earning assets, was 1.61% and 1.54% for the three and nine months ended September 30, 2017 and 2.50% and 2.25% for the three and nine months ended September 30, 2016, respectively. The primary factors impacting the net interest margin for the three and nine months ended September 30, 2017 were liabilities re-pricing faster than assets due to the LIBOR floor on assets, higher levels of liquidity due to the sale of Equipment Finance and Business Credit and a change in the composition of interest earning assets to include a greater amount of broadly syndicated loans, which typically are lower yielding. In addition to the change in loan composition, loans represented a smaller portion of the average interest earning asset balance as the Company continues to transition from an on balance sheet commercial lender towards an asset manager. The net interest margin was also impacted by lower amortization of deferred loans fees due to decreased prepayments, and an increase in the LIBOR.

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

Operating expenses as a percentage of average total assets was 1.20% and 1.14% for the three and nine months ended September 30, 2017 and 1.76% and 1.58% for the three and nine months ended September 30, 2016. The decrease period over period was primarily due to a decrease in operating expenses, specifically compensation and strategic initiative expenses, as a result of cost saving targets and sales of Equipment Finance and Business Credit, implemented during the prior year, while average total assets slightly declined from the same period in the prior year. Decline in average total assets is the result of the Company's transition from an on balance sheet commercial lender towards an asset manager for third parties.

#### Operating expenses as a percentage of average assets under management

Operating expenses as a percentage of average assets under management was 0.67% and 0.66% for the three and nine months ended September 30, 2017 and 1.09% and 0.95% for the three and nine months ended September 30, 2016. The decrease for the three and nine months ended September 30, 2017 as compared to the comparable periods in 2016 was primarily due to a reduction of compensation and strategic initiative expenses and the sale of Equipment Finance and Business Credit.

#### Efficiency ratio

Our efficiency ratio, which is total operating expenses divided by net interest income before provision for credit losses plus total non-interest income, was 56.32% and 55.06% for the three and nine months ended September 30, 2017 and 49.88% and 46.51% for the three and nine months ended September 30, 2016, respectively. The decrease in our efficiency ratio for the three and nine months ended September 30, 2017, as compared to the three and nine months ended September 30, 2016, was primarily related to non-interest income activity. Our year to date non-interest income activity decreased \$17.6 million from the previous year, which was primarily related to the gain on sale of Business Credit recognized in 2016 and negative mark to market adjustments recognized during the current year, offset by the loss on total return swap and loss on loans held-for-sale during 2016.

#### Allowance for credit losses ratio

Allowance for credit losses ratio, which is allowance for credit losses divided by outstanding gross loans excluding loans held-for-sale and fair value portfolios, was 1.52% at September 30, 2017 and 1.76% as of December 31, 2016. During the three months ended September 30, 2017, we recorded \$3.9 million of specific provision for credit losses bringing the year to date specific provision for credit losses on impaired loans to \$13.4 million. During the three months ended September 30, 2017, we had charge offs of \$8.6 million bringing the year to date charge offs to \$21.5 million. At September 30, 2017, the specific allowance for credit losses was \$11.7 million, and the general allowance for credit losses was \$28.5 million. At December 31, 2016, the specific allowance for credit losses was \$19.8 million, and the general allowance for credit losses was \$31.6 million.

#### Delinquent loan rate

Delinquent loan rate, which is total delinquent loans net of charge offs with outstanding cash receivables that are 60 days or more past due, divided by outstanding gross loans, was 1.20% as of September 30, 2017 as compared to 0.64% as of December 31, 2016. We had delinquent loans with an outstanding balance of \$36.7 million and \$21.1 million as of September 30, 2017 and December 31, 2016, respectively. The delinquent loan rate increased as the result of one new borrower during the quarter and a smaller on balance sheet loan portfolio. We expect the delinquent loan rate to correlate to current economic conditions. During times of economic expansion we expect the rate to decline, and during times of economic contraction, we expect the rate to increase, although actual results may vary.

#### Non-accrual loan rate

Non-accrual loan rate is defined as total balances outstanding of loans on non-accrual status divided by the total outstanding balance of our loans held for investment. Loans are put on non-accrual status if they are 90 days or more past due or if management believes it is probable that the Company will be unable to collect contractual principal and interest in the normal course of business. The non-accrual loan rate was 3.39% as of September 30, 2017 and 2.99% as of December 31, 2016. As of September 30, 2017 and December 31, 2016, the aggregate outstanding balance of non-accrual loans was \$103.8 million and \$99.2 million, respectively and total outstanding loans held for investment was \$3.1 billion at September 30, 2017 and \$3.3 billion at December 31, 2016. As of September 30, 2017 and December 31, 2016, these non-accrual loans had a carrying value before specific reserves of \$97.4 million and \$92.9 million, respectively.

Non-performing asset rate

Non-performing asset rate is defined as the sum of total balances outstanding of loans on non-accrual status, other real estate owned ("OREO") and other repossessed assets, divided by the sum of the total outstanding balance of our loans held for investment and other real estate owned. The non-performing asset rate was 3.88% as of September 30, 2017 and 3.45% as of December 31, 2016. As of September 30, 2017 and December 31, 2016, the sum of the aggregate outstanding balance of non-performing assets was \$119.4 million and \$115.0 million, respectively.

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

Net charge off rate as a percentage of end of period loan and lease portfolio is defined as annualized charge-offs net of recoveries divided by the total outstanding balance of our loans and leases held for investment. A charge-off occurs when management believes that all or part of the principal of a particular loan is no longer recoverable and will not be repaid. Typically a charge-off

52

---

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

occurs in a period after a loan has been identified as impaired and a specific allowance has been established. The net charge-off rate was 1.11% and 0.94% for the three and nine months ended September 30, 2017 and (0.01%) and 0.58% for the three and nine months ended September 30, 2016. During the three and nine months ended September 30, 2017, we had net charge offs of \$8.6 million and \$21.5 million, respectively. During the three and nine months ended September 30, 2016, we had a small recovery and net charge offs of \$14.2 million, respectively.

### Net charge off rate (average period loans and leases)

Net charge off rate as a percentage of average period loan and lease portfolio is defined as annualized charge-offs net of recoveries divided by the average total outstanding balance of our loans and leases held for investment for the period. The net charge-off rate was 0.99% and 0.84% for the three and nine months ended September 30, 2017 respectively, and zero and 0.50% for the three and nine months ended September 30, 2016 respectively.

### Return on average assets

Return on average assets, which is net income divided by average total assets, was 0.46% and 0.34% for the three and nine months ended September 30, 2017, respectively, and 0.84% and 0.59% for the three and nine months ended September 30, 2016 respectively.

### Return on average equity

Return on average equity, which is net income divided by average equity, was 2.82% and 2.10% for the three and nine months ended September 30, 2017 respectively, and 5.16% and 3.61% for the three and nine months ended September 30, 2016 respectively.

### Review of Consolidated Results

A summary of our consolidated financial results for the three and nine months ended September 30, 2017 and 2016 follows:

	Three Months		Nine Months Ended	
	Ended September 30, 2017	2016	September 30, 2017	2016
	(\$ in thousands)			
<b>Net interest income:</b>				
Interest income	\$58,752	\$65,155	\$170,747	\$186,499
Interest expense	43,145	39,897	126,144	117,816
Net interest income	15,607	25,258	44,603	68,683
Provision for credit losses	1,494	3,570	10,341	24,906
Net interest income after provision for credit losses	14,113	21,688	34,262	43,777
<b>Non-interest income:</b>				
Asset management income	3,544	3,353	11,017	10,337
Fee income	1,025	2,946	6,379	5,836
Realized loss on derivatives, net	—	(13 )	—	(31 )
Realized gain (loss) on sale of loans, net	294	(19 )	1,501	36
Other miscellaneous income, net	1,984	794	5,330	3,490
Mark to market adjustment on fair value loans	(867 )	3,437	(6,817 )	3,705
Loss on total return swap	—	—	—	(6,062 )

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

Unrealized (loss) gain on loans held-for-sale, net	(457 )	468	(557 )	(5,345 )
Gain on sale of Business Credit, net	—	—	—	22,511
Total non-interest income	5,523	10,966	16,853	34,477
Operating expenses:				
Compensation and benefits	7,480	13,175	21,664	32,640
General and administrative expenses	4,420	4,894	12,172	15,337
Total operating expenses	11,900	18,069	33,836	47,977
Income before income taxes	7,736	14,585	17,279	30,277
Income tax expense	3,151	5,941	7,160	12,383
Net income	\$4,585	\$8,644	\$10,119	\$17,894

Comparison of the Three Months Ended September 30, 2017 and 2016

Interest income. Interest income decreased \$6.4 million, to \$58.8 million for the three months ended September 30, 2017 from \$65.2 million for the three months ended September 30, 2016. The decrease was primarily due to a decrease in the average balance of our interest earning assets to \$3.8 billion from \$4.0 billion and a decrease in the yield on average interest earning assets to 6.07% from 6.45%. Decline in the average balance of interest earning assets is the result of the Company's transition from an on balance sheet commercial lender towards an asset manager for third parties. In addition to the decline in the average balance the composition of average interest earning assets has changed from the third quarter of 2016 due to the sale of Equipment Finance and an increase in broadly syndicated loans, which typically are lower yielding. During the quarter ended September 30, 2016 we had a nonperforming loan pay off at par on which we recognized \$3.2 million of interest income.

Interest expense. Interest expense increased \$3.2 million, to \$43.1 million for the three months ended September 30, 2017 from \$39.9 million for the three months ended September 30, 2016. The increase is primarily due to the increase in LIBOR over the past year. The average cost of funds increased to 5.21% from 4.62%.

Net interest margin. Net interest margin decreased to 1.61% for the three months ended September 30, 2017 from 2.50% for the three months ended September 30, 2016. The primary factors impacting the net interest margin for the three months ended September 30, 2017 were liabilities repricing faster than assets due to the LIBOR floor on assets, higher levels of liquidity due to the sale of Equipment Finance and Business Credit and a change in the composition of interest earning assets to include a greater amount of broadly syndicated loans, which typically are lower yielding. In addition to the change in loan composition, loans represented a smaller portion of the average interest earning asset balance. The net interest margin was also impacted by lower amortization of deferred loans fees due to decreased prepayments, and an increase in the LIBOR.

The following table summarizes the yield and cost of interest earning assets and interest bearing liabilities for the three months ended September 30, 2017 and 2016:

	Three Months Ended September 30, 2017 (\$ in thousands)			Three Months Ended September 30, 2016		
		Interest	Average		Interest	Average
	Average	Income/	Yield/	Average	Income/	Yield/
	Balance	Expense	Cost	Balance	Expense	Cost
Total interest earning assets	\$3,842,343	\$58,752	6.07 %	\$4,019,721	\$65,155	6.45 %
Total interest bearing liabilities	3,287,069	43,145	5.21 %	3,399,977	39,897	4.67 %
Net interest spread		\$15,607	0.86 %		\$25,258	1.78 %
Net interest margin			1.61 %			2.50 %

Provision for credit losses. The provision for credit losses decreased \$2.1 million to \$1.5 million for the three months ended September 30, 2017 from \$3.6 million for the three months ended September 30, 2016. During the three months ended September 30, 2017, we recorded net specific provisions for impaired loans of \$3.9 million compared to \$3.2 million for the three months ended September 30, 2016. Our general allowance for credit losses covers estimated incurred losses in our loan portfolio with respect to loans that are not impaired and for which no specific impairment has been identified. A specific provision for credit losses is recorded with respect to loans for which it is probable that we will be unable to collect all amounts d