

NEWTEK BUSINESS SERVICES, INC.

Form 10-K

March 31, 2014

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2013**

**Commission file number: 001-16123**

**NEWTEK BUSINESS SERVICES, INC.**

**New York  
(State or other jurisdiction of  
incorporation or organization)**

**212 West 35<sup>th</sup> Street, 2<sup>nd</sup> Floor New York, New York**

**11-3504638  
(I.R.S. Employer  
Identification No.)**

**10001**

(Address of principal executive offices)

(Zip Code)

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

**Securities Registered Pursuant to Section 12(b) of the Act: None**

**Securities Registered Pursuant to Section 12(g) of the Act:**

**Common Shares, par value \$0.02 per share**

**(Title of class)**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was approximately \$54,910,000 as of the last business day of the registrant's second fiscal quarter of 2013.

As of March 27, 2014 there were 36,966,672 shares issued and outstanding of the registrant's Common Shares, par value \$0.02 per share.

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**PART I**

**ITEM 1. BUSINESS.**

**Overview**

Newtek Business Services, Inc. ( we, the Company or Newtek ), *The Small Business<sup>®</sup> Advantage* provides financial and business services to the small- and medium-sized business market. Our website, [www.thesba.com](http://www.thesba.com), and our heightened branding strategy enable us to offer small businesses the ability to grow and prosper by obtaining from us:

**Business Lending:** Business loans for working capital, to acquire or expand a business or for the purchase of machinery and equipment

**Electronic Payment Processing:** Credit card, debit card, check conversion and ACH processing solutions

**Ecommerce Services:** Combinations of payment processing, online shopping cart tools, web site design, web hosting and web related services which enable businesses to establish a presence and commercial capability on the Internet in a quick and simple fashion

**Managed Technology Solutions:** Full service web hosting, including domain registration and online shopping cart tools; cloud computing plans and customized web design and development services

**The Newtek Advantage :** A mobile, real-time operating platform for business intelligence putting all critical business transactions in real-time and enabling a business to access data on a smartphone, tablet, laptop or PC for eCommerce, credit/ debit transactions, website statistics, payroll, insurance and business loans.

**Data Backup, Storage and Retrieval:** Fast, secure, off-site data backup, storage and retrieval

**Accounts Receivable Financing:** Receivable financing and management services, lines of credit collateralized by receivable accounts

**Insurance Services:** Nationwide commercial, health and benefits, and personal lines of insurance

**Payroll:** Payroll management processing and employee tax filing.

During 2013 we derived revenue through the sale of a business service or product to over 100,000 business accounts. We use state of the art, web-based proprietary technology to provide low cost products and services to our small- and medium-sized business clients. We are a FinTech company and consider our Newtracker system similar to what Salesforce.com does for tracking sales leads. Our Newtracker system tracks business referrals through our entire sales

and marketing process for all alliance partners. It is as if we are putting a barcode, like delivery services do for packages, on a business service process. This gives full transparency to referral or alliance partners as to what our business service specialists are doing with their clients 24 hours a day, 7 days per week. This gives alliance partners comfort as to what our processing personnel are doing with their customers. It gives both parties a complete audit trail. It markedly helps manage our staff as big brother is always watching and the system measure their competency in real time. We acquire our customers through the use of what we believe is our state of the art, web-based proprietary technology which eliminates the need for paying commission to feet on the street sales personnel. In addition, we acquire customers through referrals from alliances with Fortune 500® companies, community banks, credit unions and others, all of whom have elected to offer one or more of our business services and financial products rather than try to provide them directly for their customers or members. Our alliance partners have historically interfaced with Newtek through their use of our patented, proprietary NewTracker® referral and tracking system which enables complete transparency in the referral process. In 2013, we continued our major emphasis on placing resources behind the development of our coordinated marketing and media program focused on our branding strategy, featuring *The Small Business Authority* website, all intended to present the Company to the small, independent business audience as the authoritative presence in the small- and medium-sized business space across many areas of operations.

During 2013 we also took the initial steps to convert to a business development company ( BDC ) which would be regulated by the Securities and Exchange Commission as a regulated investment company and this conversion would be undertaken in conjunction with a public offering of the Company s stock. This conversion to a BDC has yet to receive final approval by the Company s board of directors and will not be completed without approval by the Company s shareholders to be considered in a special meeting likely to occur in mid-2014. There are numerous issues or considerations which could dissuade the board of directors from proceeding with BDC conversion or make completion impossible.

In general, BDCs make investments in private or thinly-traded public companies in the form of long-term debt or equity capital, with the goal of generating current income and/or capital growth. As a BDC, we intend to expand our small business financing platform by making debt and equity investments directly, as well as through our financing subsidiaries. Because we will be internally managed by our executive officers, under the supervision of our Board of Directors, and will not depend on a third party investment advisor, we will not pay investment advisory fees and all of our income will be available to pay our operating costs and to make distributions to our stockholders. Upon effectuating the BDC Election, certain of our

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historical operating subsidiaries will be treated as non-consolidated portfolio companies. The revenues that these companies generate, after deducting operational expenses and taxes, may be distributed to us in the form of dividend or interest income in connection with our equity or debt investments in such entities. As a BDC, our board of directors will determine quarterly the fair value of our controlled portfolio companies in a similar manner as our other investments. We believe that transitioning to a BDC will provide us with access to lower-cost capital and enable us to expand our lending activities. As a BDC, we will seek to generate both current income and capital appreciation primarily through loans originated by our small business finance platform and our equity investments in certain portfolio companies that we control.

As a BDC, and the related tax status as a regulated investment company under provisions of applicable tax law, we generally will not have to pay corporate-level federal income taxes on any ordinary income or capital gains that we distribute to our stockholders. To obtain and maintain this tax treatment, we must meet specified source-of-income and asset diversification requirements and distribute annually at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any.

## **History**

Newtek is a corporation formed under the laws of New York that serves as a holding company for several wholly- and majority-owned subsidiaries. We were founded in 1998 to provide debt and equity financing to small- and medium-sized businesses. We have since developed our branded line of business and financial products and services for the small- and medium-sized business market. At December 31, 2013, we had 6 principal subsidiaries, and 30 other minor controlled entities, most of which are direct providers of financial and business services.

Initially, Newtek was the sponsor of a total of 16 certified capital companies, which we call Capcos, now reduced to 11. We have not created any new Capcos since 2005, although we continue to make investments in and loans to small businesses through our existing Capcos and meet the goals of the Capco programs. We are now concentrating our efforts on becoming The Small Business Authority by creating a distribution channel for business and financial services provided by our subsidiaries, affiliates or marketing partners for the small- and medium-sized business market supported by a coordinated direct, national advertising campaign. At present, we are placing approximately 300 sixty second commercials on television each month.

## **Business Strategy**

***Key elements of our strategy to grow our business are:***

***Continue to focus our business model to serve the small- and medium-sized business market.*** We are focused on developing and marketing business and financial products and services aimed at the small- and medium-sized business market and on developing a recognized brand for independent business owners. Our target market represents a very significant marketplace in the United States based on non-farm private gross domestic product ( GDP ). According to statistics published by the U.S. Small Business Administration (the SBA ), approximately 51% of the GDP in the United States comes from small businesses and approximately 99% of businesses in the United States which have one or more employees fit into this market segment. Our business model is to get that market to view us as The Small Business Authority and come to depend on us as their source for business and financial services as well as the business information they need. We intend to continue to leverage the Newtek® and The Small Business Authority® brands, as well as other trademarked name brands, (The Cloud Authority, The Business Authority, The Health Insurance Authority, The IT Authority) as a one-stop-shop provider for the



small- and medium sized business market.

***Continue to implement a strategy of acquiring customers and processing their business at low cost.*** We seek to acquire customers at a low cost through a national strategy centered on our alliance partners, internet marketing, coordinated marketing, social media and our NewTracker technology. Our FinTech approach to acquiring business clients is a key to our success and we believe is a more cost effective acquiring strategy than one used by our industry peers. Our alliance partners use our proprietary NewTracker referral system to refer customers to us for sales and customer tracking and processing. NewTracker distributes the referral to our appropriate business segment or segments for fulfillment while keeping our alliance partners up to date on the customer's progress in real time with detailed documentation. We use the same proprietary system as our gateway for direct sales through our websites and our BizExec program. In addition, during 2013 we placed significant resources into direct media advertising under the banner of our *The Small Business Authority* mark. This ties together significant national media exposure through television and radio advertising, design

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and production of our Small Business Index and SB Market Sentiment Surveys reflecting our polling and assessment of business conditions for small- and medium-sized businesses, the active use of social media marketing, and website (www.thesba.com).

***Continue to develop our state-of-the-art technology to process business applications and financial transactions.*** We continue to update our proprietary systems to take advantage of technological advances that provide state of the art enhancements in client service and process controls which lead to lower costs. During 2012 we completed the development of the Newtek Advantage , our Internet (or cloud) based operating platform, which has a patent pending, to integrate customer reports for all of our business services in a simple, straightforward mobile application accessible by the business in real time and at any time. The current working modules are payroll, payment processing and web traffic statistics. We intend to add insurance, lending and digital financial reports, and digital tax similar to Intuit 's offering through Quickbooks.

***Continue our focus on the Internet and The Small Business Authority mark.*** Our major goal continues to be to focus *the Small Business Authority* branding strategy and to establish thesba.com as the online destination spot for small business. Features of thesba.com that have impact on small business owners include:

Free monthly newsletters designed and written for independent, small business owners

The Small Business Authority Index

The Small Business Authority Market Sentiment Survey

Regular news reports and updates about the economy for the small business owner

Informative and engaging SB authority informational videos

Pertinent information on acquiring products and services for independent business owners to prosper

***Continue to fulfill our obligations under the current Capco programs.*** Our emphasis is on continuing our exemplary regulatory compliance program in order to complete successfully the investment cycles for all Capcos. At December 31, 2013, we reached the final minimum investment requirements in all Capco programs in which we participated. We believe this ensures that 100% of the tax credits related to the programs are beyond risk of recapture. In addition, as of that date, all of the cash payments required to be made to the investors have been made. As the Capcos reach 100 percent investment we will seek to decertify them as Capcos, liquidate their remaining assets and thereby reduce our operational costs, particularly the legal and accounting costs associated with compliance. Four of our original Capcos have reached this stage and in addition, a fifth Capco we manage reached 100% investment in early 2014.

*We are adding to our strategy an increased emphasis on outbound telemarketing and data mining.* The business we do with small and medium-sized businesses has enabled us to develop a significant and growing database of customers and we are adding key staff and devoting resources to cross-selling opportunities this presents so we can develop the full potential of our business model.

## **Principal Business Segments**

### *Overview*

The Company's principal business segments, which we operate in a coordinated manner in order to provide business and financial services to the small- and medium-sized business market, are:

**Small Business Finance:** This segment is comprised of Newtek Small Business Finance, Inc. ( NSBF ), a nationally licensed, SBA lender that originates, sells and services loans to qualifying small businesses, which are partially guaranteed by the SBA, and CDS Business Services, Inc. d/b/a Newtek Business Credit ( NBC ), which provides receivable financing, revolving lines of credit and billing management services. An additional subsidiary, Small Business Lending, Inc., engages in loan servicing for non-SBA loans.

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

**Managed Technology Solutions:** Offers shared and dedicated web hosting, data storage and backup services, cloud computing plans and related services to the small- and medium-sized business market.

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

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

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

Financial information for each segment can be found in Management's Discussion and Analysis of Results of Operations and Financial Condition, Segment Results and Note 24-Segment Reporting to the Consolidated Financial Statements, below.

### ***Small Business Finance***

We originate SBA loans and offer accounts receivable financing and other lending products essential for small- and medium-sized businesses. In addition, we provide small business loan servicing and consulting to the Federal Deposit Insurance Corporation ( FDIC ) and to numerous other financial institutions.

Newtek Small Business Finance, Inc. ( NSBF ) specializes in originating, servicing and selling small business loans guaranteed by the SBA for the purpose of acquiring commercial real estate, machinery, equipment and inventory and to refinance debt and fund franchises, working capital and business acquisitions. NSBF is one of 14 SBA licensed Small Business Lending Corporations that, along with licensed financial institutions, provide loans nationwide under the federal Section 7(a) loan program ( SBA 7(a) loans ). NSBF has received preferred lender program (PLP) status, a designation whereby the SBA authorizes the most experienced SBA lenders to place SBA guarantees on loans without seeking prior SBA review and approval. Being a national lender, PLP status allows NSBF to serve its clients in an expedited manner since it is not required to present applications to the SBA for concurrent review and approval. In December 2010, Standard & Poor's ( S&P ) Ratings Services added NSBF to their Select Servicer List which has been helpful to the Company in obtaining additional outside servicing contracts.

We originate loans ranging from \$50,000 to \$5,000,000 to both startup and existing businesses, which use the funds for a wide range of business needs including:

opening, expanding or acquiring a business or franchise: \$50,000 to \$5,000,000;

financing working capital:

SBA term loans: at least \$50,000

Purchase equipment: \$25,000 to \$5,000,000

purchasing owner-occupied commercial real estate and leasehold improvements: up to \$5,000,000; and

refinancing existing non-real-estate business debt: \$25,000 to \$5,000,000.

As of December 31, 2013, we service over \$1 billion in business loans for ourselves and others involving over 1,600 customers

have created successfully created and financed four Standard & Poors-rated securitizations

secured a \$75,000,000 commitment from Goldman Sachs Bank USA to finance and warehouse SBA 7(a) loans; and

exceeded our public guidance and funded in excess of \$175,000,000 in SBA 7(a) loans for the year.

Late in 2009, we were selected by the FDIC as its contractor to manage and service portfolios of SBA 7(a) loans acquired by the FDIC from failed financial institutions. In addition, we assist the FDIC in the packaging of these loans for sale. Our existing servicing facilities and personnel perform these activities supplemented by contract workers as needed. The size of the portfolio we service for the FDIC varies and depends on the level of bank failures and the needs of the FDIC in managing portfolios acquired from those banks. As of December 31, 2013, we were servicing approximately \$500,000,000 in loans under this and all other third party contracts, in addition to the other approximately \$500,000,000 originated loans we service as of February 27, 2014.

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***Loan Securitizations:*** Beginning in December 2010 NSBF has developed a process to structure loan securitization transactions enabling it to move the unguaranteed portions of loans it originates into securitization trusts and to sell debt securities issued by these trusts. The securities sold were rated AA or A by S&P. In all, in transactions in 2010, 2012 and 2013, NSBF has sold approximately \$76,243,000 in unguaranteed loan portions in four transactions. NSBF typically retains the unguaranteed portions of the loans it originates and incurs related warehouse financing costs. With the sales, NSBF was able to create significant liquidity which was used to pay down the warehouse line and to fund new loans. The success of these securitization sales has encouraged us to believe that we will be able to continue this process successfully as long as market and other conditions permit.

NSBF has in addition historically relied on bank financing to provide the revolving financing to support its lending activities. Currently Capital One, N.A. provides a \$27 million line for financing SBA guaranteed loans and NSBF has entered into a non-binding letter of intent with Goldman Sachs Bank for a replacement line of at least \$75 million for this purpose. The Goldman Sachs line documentation is awaiting SBA approval.

We also offer accounts receivable financing and management services through CDS Business Services, Inc. d/b/a Newtek Business Credit ( NBC ). Through this service, small- and medium-sized businesses can obtain \$10,000 to \$2,000,000 per month through the sale of their trade receivables or through a revolving line of credit collateralized by receivable accounts. NBC also offers back office receivables services for small businesses, such as billing and cash collections.

Another subsidiary, Small Business Lending, Inc., has during 2013 become the focus of the Company's efforts to expand loan servicing in non-SBA areas.

In addition, we offer merchant cash advance services to our small business customers, under which merchants obtain cash by selling future credit card receivables at a discount. Under this program, the merchant receives the purchase amount upfront and agrees to have a set percentage of the credit card sales deducted from its daily deposits and remitted back until the purchase amount is repaid; in most cases we process the payment streams. We offer these services on a fee basis as an agent for third party providers and are not taking on credit risk in connection with these services.

## ***Electronic Payment Processing***

Newtek Merchant Solutions ( NMS ) markets credit and debit card processing services, check approval services and ancillary processing equipment and software to merchants who accept credit cards, debit cards, checks and other non-cash forms of payment. New merchants are acquired through several sales channels. Our primary focus is on developing new merchant sales leads as a result of internal sales efforts and our direct marketing under *The Small Business Authority* brand. NMS has targeted the marketing of its array of services under agreements with alliance partners, which are principally financial institutions, including banks, credit unions and other related businesses that are able to refer potential customers to NMS through Newtek's NewTracker referral system. In addition, we enter into agreements with independent sales agents throughout the country. These referring organizations and associations are typically paid a percentage of the processing revenue derived from the respective merchants that they successfully refer to us. In 2013, we processed merchant transactions with a sales volume exceeding \$4.6 billion, up over \$400 million from the previous year, including merchant portfolios operated by our other subsidiaries which are serviced by NMS. Our customer base and the related sales volume processed by us has grown significantly during each year of operations since 2002 through a combination of organic growth in customers as well as selective merchant portfolio acquisitions. Our merchant base has grown from approximately 1,200 merchants at the end of 2002 to approximately 14,200 merchants at the end of 2013. In January 2013, we made significant changes in the management of this segment, adding Eric Turille, with over 20 years of experience in large scale payment processing acquisition

businesses, including as the President of First National Bank of Omaha, Merchant Services, COO and Head of Sales at Vital Processing and COO of Retriever Merchant Services. Mr. Turille has also served on several VISA and MasterCard committees. In 2013 we also added Thomas Harkins as a Senior Vice President and Chief Credit and Risk Officer, who has over 30 years experience in the industry, including over 20 years at MasterCard International, focused primarily on security and risk management.

We maintain two main customer service and sales support offices in Milwaukee, Wisconsin and Brownsville, Texas with additional specialists located in Phoenix, Arizona and New York. Our personnel at these locations assist merchants with initial installation of equipment and on-going service, as well as any other special processing needs that they may have.

Because we are not a bank, we are unable to belong to and directly access the Visa<sup>®</sup> and MasterCard<sup>®</sup> bankcard associations and we must be sponsored by a bank in order to process bankcard transactions. We are currently registered with Visa<sup>®</sup> and MasterCard<sup>®</sup> through the sponsorship of two banks that are members of the card associations, Wells Fargo Bank, N.A. and, since January 2011 Redwood Merchant Services, a division of WestAmerica Bank.

Our electronic payment processing businesses rely on our ability to obtain data processing services. There are two aspects to the processing: the initial authorization of a payment (referred to as the front-end processing ) and the merchant credit and cardholder charge transaction (the back end processing ). In 2009, we signed agreements with Wells Fargo Bank to

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diversify our processing operations and with First Data Corporation to reduce our costs. We contract with several large-scale data processing companies to provide the front-end and back-end processing (Chase Paymentech Solutions, LLC, First Data Merchant Services Corporation (multiple platforms), Total Systems Services, Inc. (TSYS), and National Processing Company (NPC)); these multiple platforms allow us to compete more effectively, reduce our risk of reliance on any one source, and give us the option of utilizing different processors to match the needs of particular merchants or situations. As our merchant base has grown, we believe that we have been able to achieve greater economies of scale in terms of negotiating the cost structure for providing such settlement services.

We continue to work with an affiliate, Secure Gateway Services, LLC, which has the software and experience to provide a processing gateway facility for our payment processing business. This has resulted in increased integration of customer payment processing data with our Newtek Advantage software platform providing a mobile application allowing the customer to monitor charge processing activity in real time.

As a result of our exposure to liability for merchant fraud, charge-backs and other losses inherent in the merchant payment processing business, we have developed practices and policies which attempt to assess and reduce these risks. Activities in which we engage in order to mitigate such risks are:

- underwriting the initial application of a merchant to identify unusual risks, structuring the relationship in a manner consistent with acceptable risks and, where possible, obtaining a personal or parent corporation guarantee from the merchant;

- monitoring the daily and monthly activity of each merchant to identify any departures from normative charging behavior of each merchant and monitoring the largest of our merchants and those with high levels of refunds or charge-backs, so as to ensure an opportunity to address any credit or charge-back liability problems at the earliest possible time; and

- requiring high-risk merchants to agree to the establishment of cash reserves to protect us against merchant failures to pay for charge-backs and other fees, and making adjustments in these reserves as merchant experience indicates; we believe we have limited exposure to such high-risk merchants.

Our development and growth are focused on selling our services to internally generated referrals, merchant referrals identified for us by our alliance partners, and, with additional emphasis since January 2013, by our independent sales representatives, at which time we added a team of professionals experienced in the development and management of large scale independent sales forces. We are still different than most electronic payment processing companies who acquire their clients primarily through independent agents. We believe that our business model provides us with a competitive advantage by enabling us to acquire new electronic payment processing merchants at a lower cost level for third-party commissions than the industry average. Our business model allows us to own the customer as well as the stream of residual payments, as opposed to models which rely more heavily on independent sales agents. Also during 2013 we devoted resources to the design and testing of systems to allow us to offer to our merchant customers state of the art technology in meeting the expected future requirements of the card associations for the implementation of the Europay, MasterCard, Visa ( EMV ) smart card technology. This is a global standard for interactive, integrated circuit cards and related point of sale terminals that will use cards imbedded with computer readable chips. We believe that this standard, which has been adopted in many areas outside the United States will be implemented here and we are positioning Newtek Merchant Services to be leader or authority in this field. In doing this we have the benefit of our affiliated technology companies who are able to provide the technological expertise needed for this project.



***Managed Technology Solutions***

Through our subsidiary, CrystalTech Web Hosting, Inc. d/b/a/ Newtek Technology Services® ( NTS ), we provide website hosting, dedicated server hosting, cloud hosting, web design and development, internet marketing, ecommerce, data storage and backup, and other related services to more than 124,000 customer accounts in 105 countries.

NTS provides a full suite of outsourced IT infrastructure services, including shared server hosting, dedicated server hosting, and cloud server (virtual) instances under the Newtek Technology Services®, Newtek Web Services®, Newtek Web Hosting, and CrystalTech® brands, for which it receives recurring monthly fees, as well as other fees such as set-up fees, consulting fees, domain name registration fees, among others. Ninety percent of all fees are paid in advance by credit card.

NTS has recognized the continuing decline in Microsoft being utilized in the design of web sites and the market shift to Linux, Nginx and a proliferation of Word Press sites being built on non-Microsoft based platforms. This decline has caused a marked downward trend in the historical site count of NTS hosted sites. NTS has responded by launching Linux Apache and Linux Nginx platforms within its environment and created associated control panels, service/support and billing to participate more fully in 100% of the market as compared to the present 33% of the new web design growth represented by Microsoft. All platforms are available within NTS' s Cloud and non-cloud environment and are fully managed offerings as compared to

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our competitors. In addition, Newtek has created a proprietary platform and filed an associated patent for Newtek Advantage which leverages NTS's underlying technologies to deliver real time information and actionable business intelligence to its existing and new customer base.

NTS has launched a complete line of cloud based business and eCommerce packages, Cloud Spaces, to streamline the decision process for business owners and accommodate designers and developers that wish to build sites in both Microsoft and Linux environments. NTS's Cloud offerings provide for a consumption-based hosting model that allows customers to pay only for the resources they need, which not only saves them money compared to traditional server hosting, but also enables them to scale larger or smaller on demand.

NTS delivers services not just to customers seeking hosting, but also to wholesalers, resellers and web developers by offering a range of tools for them to build, resell and deliver their web content. NTS primarily uses the Microsoft Windows® 2012 R2 platform to power its technology. Microsoft has described NTS as one of the largest hosting services in the world providing Microsoft Windows hosting. NTS currently operates a 5,000 square foot fortress-strength data center located in Scottsdale, Arizona, utilizing redundant networking, electrical and back-up systems, affording customers what management believes to be a state-of-the-art level of performance and security. NTS is PCI certified, Service Organization Control 1 (SOC 1) audited, and is currently completing a SSAE 16 audit, all of which mean that it meets the highest industry standards for data security.

Throughout its operations as a Newtek company, over seventy percent of new NTS customers have come as a result of referrals without material expenditures by the Company for marketing or advertising. Many of NTS's competitors are very price sensitive, offering minimal services at cut-rate pricing. While being cost competitive with most Linux- and Windows-based web hosting services, NTS has emphasized higher quality uptime, service and support as well as multiple control panel environments for the designer and developer community.

NTS has diversified its product offerings to small- and medium-sized businesses under different brands, all under Newtek Technology Services, including Newtek Hosting, Newtek Web Services, Newtek Data Storage® and Newtek Web Design and Development®. NTS focuses specifically on select markets such as restaurants, financial institutions, medical practices, law firms, accountants, retail and technology service providers for channel business and reselling. NTS has also launched a turnkey hosting service to meet financial institution needs for dedicated servers, hosting and/or data storage, enabling these entities to comply with strict regulatory requirements that demand very high security protocols and practices be in place.

NTS differentiates itself from its larger cloud hosting competitors, such as Amazon, Google and Microsoft, by offering what we believe these competitors cannot and yet is the one element absolutely critical to small and medium-sized businesses: a live person, available 24/7/364 to answer questions, address needs or problems with software or hardware. We have continued to add to our resources to ensure that our customers have access to the high quality support they need for the features, functions and services of their internal IT operations.

### ***All Other: Insurance and Payroll Processing Services***

We offer small business insurance products and services through Newtek Insurance Agency, LLC (NIA), which is licensed in 50 states. We serve as a retail and wholesale agency specializing in the sale of personal, commercial and health/benefits lines insurance products to customers of all our affiliated companies as well as our alliance partners. We offer insurance products from multiple insurance carriers providing a wide range of choice for our customers. We have formed a strategic alliance with American International Group, CTAA, Navy Federal Credit Union, Credit Union National Association, Pershing and others to provide agent services to small business clients. We are continuing our efforts to implement programs with alliance partners to market commercial and personal insurance. In December

2012, NIA working with another of our companies acquired a portfolio of insurance business from a major health care insurance agency based in the New York City area. This has added approximately 340 group health insurance policies that we are servicing and will form the basis on which we plan to grow this aspect of the insurance business. We expect also that recent health care legislation will increase the demand for these services among small and medium-sized businesses.

During 2013 we placed significant emphasis on developing the business conducted by our majority-owned, affiliated company operating under the trade name of Newtek Payroll Services. This investment was originally made in 2010, and enables the Company to offer an array of industry standard and very competitively priced payroll management, payment and tax reporting services to small- and medium-sized businesses. Based in New York, Newtek Payroll Services has built up its business during 2013 to approximately 465 customers in 38 states with total payroll under management of approximately 2,967 employees, of which approximately 11% were Newtek employees, an increase in customer count of 30% and employee count of 79% over the previous year. These payroll services are being marketed through all of our available channels including the alliance partnerships and our direct marketing campaigns. During 2013, the sole supplier of automated

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clearinghouse transfer services to the company experienced major internal problems and ceased operations. In response, Newtek Payroll Services has diversified its principal suppliers and instituted more rigorous review of all relationships for credit and reputational risk management. In addition, Newtek Payroll Services has participated in litigation with other former customers of the supplier in order to obtain recovery of the funds lost due to the unauthorized actions of the supplier and its bank.

### ***Corporate Activities***

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

### ***Certified Capital Companies***

We have deemphasized our Capco business in favor of growing our operating businesses and do not anticipate creating any new Capcos. While observing all requirements of the Capco programs and, in particular, financing qualified businesses meeting applicable state requirements as to limitations on the proportion of ownership of qualified businesses, we have been able to use this funding source as a means to facilitate the growth of our businesses, which are strategically focused on providing goods and services to small businesses such as those in which our Capcos invest. We continue to invest in and lend to small businesses through our existing Capcos and meet the goals of the Capco programs.

## **Marketing**

### ***Overview***

We position ourselves as a provider of business and financial services to the small to medium business sector in the United States. Through integrated marketing and sales of each service line we control our customer's experience in order to provide high quality service to both our marketing partners and potential customers. We reach potential customers through our multi-channel approach featuring direct, indirect and direct outbound solicitation efforts.

Although we continue to utilize and grow our core marketing channel of strategic alliance partners, we have initiated a direct marketing strategy to the small- and medium-sized business customers through our new go to market brand, The Small Business Authority. Through this brand we are establishing ourselves as the authority in each of the service lines we provide through a coordinated radio and television advertising campaign built around our new web presence, [www.thesba.com](http://www.thesba.com). We continue to market through our bilingual 24/7 call center which we believe is a valuable feature for most small business owners that need help during non-business hours and on weekends. We use web-based applications as an in-house tool to help our employees and associates to be efficient, smart and productive. Instead of using expensive, six-figured salaried employees that a typical bank or an insurance agency would use to market financial products and business services to small- and medium-sized business customers, we use technology and dedicated loyal non-executive-salary-plus-bonus employees. The addition of the direct to market strategy through promotion of our new web site supports our goal to maintain costs and retain greater margin on each transaction as well as providing our competent in house business service specialists the ability to create a second and third product and service opportunities.

We believe that our business service specialists on all product lines understand the needs of the small business owner. Each business service specialist in the enterprise has recently completed our Newtek University which provides in depth training and techniques in identifying qualified opportunities across all of Newtek's service offerings. We conduct telephone interviews and targeted surveys with our customers across all product lines to deepen our understanding of their needs. We have tailored our procedures so our small- and medium-sized business customers do not have to fill out multiple handwritten forms or type multiple data entry screens, which we believe is the most aggravating factor facing our customers. We have modeled our back-office and business operations after customer centered operational models. We stress our responsive customer service and we endeavor to excel in addressing and resolving issues and problems that our customers may face. We are now providing our 24/7 customer service functions in Spanish as well as English to service the growing Hispanic-owned and -operated small business customer base in the United States.

We also market our services through referrals from our alliance partners such as AIG, Credit Union National Association, Iberia Bank, Pershing, New York Community Bank, Morgan Stanley Smith Barney, ENT Federal Credit Union, Randolph Brooks Federal Credit Union and Nassau Educators Federal Credit Union using our proprietary NewTracker referral system as well as direct referrals from our new web presence, [www.thesba.com](http://www.thesba.com). Additional referrals are obtained from individual professionals in geographic markets that have signed up to provide referrals and earn commissions through our BizExec and TechExec Programs. These individuals are traditionally information technology professionals, CPAs, independent insurance

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agents and sales and/or marketing professionals. In addition, electronic payment processing services are marketed through independent sales representatives and web technology and ecommerce services are marketed through internet-based marketing and third-party resellers. A common thread across all business lines relates to acquiring customers at low cost. We seek to bundle our marketing efforts through our brand, our portal, our proprietary NewTracker technology, our new web presence as *The Small Business Authority* and one easy entry point of contact.

We have implemented a multi-channel marketing strategy that consists of:

**Direct:** In September 2012, the Company launched a redesign of the corporate website, [www.thesba.com](http://www.thesba.com). The goal of the new site is to focus on helping business owners succeed by providing them high quality business services, testimonials, case studies and a daily blog. In addition, the site delivers promotions to aid in acquiring clients and creating higher levels of customer referrals. The website is consistent with Newtek's national television campaign and on-line messaging, positioning it as a national provider of business services and financial products to the more than 27 million small and independently owned and operated businesses across the United States.

Since September 2012 Newtek has used Ocean Media, Inc. as its media planner and buyer. Ocean Media specializes in media planning and buying for the delivery of effective television and advertising strategies. It has created innovative media campaigns for several companies such as [Priceline.com](http://Priceline.com), [Angieslist.com](http://Angieslist.com) and [eHarmony.com](http://eHarmony.com). Newtek commercials are aired on CNN, Fox Business, Fox News, Headline News, MSNBC and the Outdoor channel.

To supplement our direct marketing efforts, we have developed two proprietary vehicles to enhance the visibility and credibility of *The Small Business Authority* and the related website *thesba.com*. The Small Business Index was developed internally and trademarked during 2011. It is a monthly assessment of various factors indicative of business conditions in the small business market. Since its introduction, it has received a great deal of publicity and is now quoted in numerous national publications. In addition, we also introduced in 2011 our internally developed *SB Market Sentiment Survey*, which captures responses from our website visitors on topics of significant importance to our small business customers. This survey has also gained much national attention. We believe that both of these efforts add significantly to our marketing efforts and further support our efforts to become the one-stop-shop for all small businesses.

A final addition to our direct marketing efforts is our effort to give *The Small Business Authority* a social media presence. We have dedicated staff familiar with the latest developments in social media and we have been active in placing blog articles, videos and special promotions on numerous social media sites. We distribute this type of content multiple times daily and attempt to engage with customers and others on a similar basis. Our staff follows numerous blog sites related to our businesses and attempts to post relevant materials and information that both addresses small and medium sized business needs and interests and identifies the ways in which *The Small Business Authority* can address many of those needs.

**Indirect:** Our alliance partners market one or more of our services to their customer base or members, and utilize NewTracker to submit referrals to Newtek from either their website or directly by their staff. Through our BizExec and TechExec Programs, we are recruiting individual professionals such as insurance agents, lawyers and accountants, or website designers or software developers, who utilize NewTracker through a link to NewTracker from their own site or the establishment of a new website.

**Direct Outbound:** We combined all data assets into a seamless, enterprise-wide, accessible master database in order to facilitate cross marketing, selling and servicing, real-time data mining and business intelligence. We have established a dedicated team to use our master database for cross marketing, selling and servicing.

***The Newtek Referral System***

Our proprietary NewTracker® referral system, on which a patent has been issued, allows us to process new business utilizing a web-based, centralized processing point. In-bound referrals from alliance partners, our website and other sources are transmitted to our businesses to provide the service or services our customers need. Our trained representatives use these web-based applications as a tool to acquire and process data through telephonic interviews, eliminating the need for face-to-face contact and the requirement that a customer complete multiple paper forms or data entry for multiple product lines. This approach is customer friendly, allows us to process applications very efficiently and allows us to store client information for further processing and cross-selling efforts while offering what we believe to be the highest level of customer service. It also assures our alliance partners full transaction transparency. This system permits our alliance partners to have a window to our back office processing 24 hours a day, 7 days a week, to see every communication and interaction between our sales and processing representatives and their referred customers while still preserving the privacy of customer or alliance partner sensitive data on the application. NewTracker enables the processing and tracking of services in a manner similar to the bar

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code system used by overnight delivery services. We believe that NewTracker is a key differentiating component of our business. It enables us to scale our business services rapidly to meet the demands of our customers. NewTracker enables our alliance partners to offer our services immediately, without having to invest in marketing materials, sales and marketing personnel, training, licensing or office space. Because their customers or members are driven by our technology to our processing centers, which can handle increased volume of transactions without having to add specialized staff or infrastructure, there is no need for additional investment by our alliance partners. NewTracker additionally provides direct interface to business owners/operators accessing our new web site as they provide basic information regarding their need so that our Business Service Specialists can immediately respond to inquiry for any of our service offerings. The Company is also beginning to explore the possibility of marketing some aspect of the patented technology as it represents a unique capability for sales organizations as it not only manages intake of business but enables real time management of client service functions.

### *Alliances*

Each of the operating businesses benefit from the receipt of significant numbers of customer referrals from our alliance partners, pursuant to agreements negotiated and structured by our holding company management and staff. We are focused on using strategic business affiliations to identify likely small- to medium-sized business customers and others to be serviced by our operating businesses. We seek to ally Newtek with companies and organizations that wish to offer one or more of our principal business lines to their customers or members. We provide one-stop shopping for alliance partners that want to launch or expand their business services. For example, many credit unions are serving small business owners with consumer lending applications, but can use our alliance with Credit Union National Association and scores of small to large credit unions and community banks to expand their offering of services. We are also able to private label any of our business services for any alliance partner.

These alliance partners are able to provide greater service to their customers and members and derive a steady flow of referral payments from us. On the other hand, our operating companies are receiving significant numbers of referrals for our services in the areas of small business loans, insurance and electronic payment processing and are thus acquiring customers at a low cost. NewTracker, our proprietary, internally developed referral system technology, facilitates this transfer of information and also permits our customer service representatives, their supervisors and the referring alliance partners to observe the real-time processing of each referral, from intake to completion. For example, an alliance partner financial advisor who refers a brokerage customer for electronic payment processing, can track our processing of their client and know when decisions are made, what they are, when the referral fees are earned, as well as observe and oversee the operational performance of our customer service representatives. The process is analogous to the bar code system used by overnight delivery services to track the movement of a package, where critical processing points are input and the customer is able to access the company's password-protected web site and monitor the movement of the package from pick-up to delivery.

We have entered into agreements to provide one or more business services with numerous national and regional businesses or organizations including, but not limited to:

Morgan Stanley Smith Barney

New York Community Bank



Credit Union National Association (CUNA)

Microsoft

American International Group

Pershing

Members 1<sup>st</sup> Federal Credit Union

Ent Federal Credit Union

IBERIABANK

Bellco Credit Union

Wright Patt Credit Union

SpaceCoast Credit Union

Nassau Educators Federal Credit Union

Randolph Brooks Federal Credit Union

Desert Schools Federal Credit Union

Brownsville (TX) Chamber of Commerce

**Intellectual Property**

Newtek has developed software which is the core of its NewTracker referral system and in September 2006 filed a patent application with the United States Patent and Trademark Office covering NewTracker.

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NTS uses specialized software to conduct its business under a perpetual, royalty-free license from its developer, the former owner of CrystalTech, acquired at the time of our acquisition of the business.

We have several trademarks and service marks, all of which are of material importance to us. The following trademarks and service marks are the subject of trademark registrations issued by the United States Patent Trademark Office:

1. AT NEWTEK, WE DO IT BETTER
2. BIZEXEC
3. CRYSTALTECH
4. CRYSTALTECH WEB HOSTING
5. CT & Design
6. NEWTEK
7. NEWTEK BIZEXEC
8. NEWTEK BUSINESS SERVICES
9. NEWTEK BUSINESS SOLUTIONS
10. NEWTEK + NEWT LOGO
11. NEWTEK REFERRAL SYSTEM
12. NEWTEK TECHNOLOGY SERVICES
13. NEWTEK WEB SERVICES

14. NEWTRACKER
15. WEBCONTROLCENTER
16. NEWTEK BUSINESS CREDIT
17. NEWTEK DATA STORAGE
18. NEWTEK WEB DESIGN AND DEVELOPMENT
19. NEWTEK WEB HOSTING
20. WE DO IT BETTER
21. A NEW WAY TO THINK ABOUT SMALL-BUSINESS IT
22. THE CLOUD AUTHORITY
23. THESBA.COM THE SMALL AUTHORITY POWERED BY NEWTEK
24. THE SMALL BUSINESS AUTHORITY
25. THE SMALL BUSINESS AUTHORITY HOUR
26. NEWTPAY PRO
27. NEWTPAY
28. NEWTEK BUSINESS SERVICES, INC. + NEWT LOGO
29. THE CLOUD AUTHORITY + DESIGN
30. THE SMALL BUSINESS AUTHORITY HOUR + DESIGN

31. THESBA
32. THE SBAUTHORITY INDEX
33. THE SMALL BUSINESS AUTHORITY INDEX
34. THESBA INDEX
35. NEWTEK SITECENTER
36. NEWTEK PAYROLL
37. CONTINUOUS CYBER SECURITY SCANNING
38. THE BUSINESS AUTHORITY
39. CLOUD AUTHORITY
40. INSURED CLOUD COMPUTING
41. THE PAYROLL AUTHORITY
42. THE ECOMMERCE AUTHORITY
43. THE MOBILE APPLICATION AUTHORITY
44. THE HEALTH INSURANCE AUTHORITY
45. THE IT AUTHORITY
46. NEWTEK ADVANTAGE
47. NEWTEK HOSTING

The following trademarks and service marks are the subject of pending trademark applications filed with the United States Patent and Trademark Office:

1. NEWTEK INSURED CLOUD COMPUTING
2. NEWTEK INSURED HOSTING

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3. NEWTEK INSURED MERCHANT PROCESSING
4. NEWTEK INSURED PAYROLL
5. THE PAYROLL AUTHORITY
6. THE SMALL BUSINESS TECHNOLOGY AUTHORITY
7. THE TECHNOLOGY AUTHORITY
8. NEWTEK INSURED ECOMMERCE
9. NEWTEK INSURED MERCHANT SERVICES
10. NEWTEK EDGE

**Government Regulation**

*Overview*

Newtek's electronic payment processing, lending, insurance, and Capco operations are subject to regulation by federal, state and professional governing bodies. In addition, our financial institution customers, which include commercial banks and credit unions, operate in markets that are subject to rigorous regulatory oversight and supervision. The compliance of our products and services with these requirements depends on a variety of factors including the particular functionality, the interactive design and the charter or license of the financial institution. Our financial services customers must independently assess and determine what is required of them under these regulations and are responsible for ensuring that our systems and the design of their websites conform to their regulatory obligations. New laws or regulations are frequently adopted in these areas that require constant compliance and could increase our costs.

*Certified Capital Companies*

In return for the Capcos making investments in the targeted companies, the states provide tax credits, generally equal to funds invested in the Capco by the insurance companies that provide the funds to the Capcos. In order to maintain its status as a Capco and to avoid recapture or forfeiture of the tax credits, each Capco must meet a number of specific investment requirements, including a minimum investment schedule all of which have been met prior to required dates by all of our Capcos. As a result, we believe there is no basis for a loss of tax credits.

Each of the state Capco programs has a requirement that a Capco, in order to maintain its certified status, must meet certain investment requirements, both qualitative and quantitative, all of which the Company's Capcos have met. These include limitations on the initial size of the recipients of the Capco funds, including the number of their employees, the location within the respective state of the recipients and the recipients' commitment to remain therein for a specified period of time, the types of business conducted by the recipients, and the terms of the investments in the

recipients.

The states of Louisiana, Colorado and Texas and the state of New York have added to their Capco programs limitations on the equity investment Capcos can make in qualified businesses. These programs or program changes seek to preclude a Capco from owning all or a majority of the voting equity of the invested business. While Newtek has made profitable majority-owned investments in the past, we have also made minority or passive investments in qualified businesses. Newtek's Capcos are in full compliance with all investment limitations, and management foresees no significant difficulty in continuing to remain in compliance.

When each of Newtek's Capcos has invested in qualified businesses an amount equal to 100% of its initial certified capital, it is able to decertify (terminate its status as a Capco) and no longer be subject to any state Capco regulation. Upon voluntary decertification, the programs in about half of the states require that a Capco share any distributions to its equity holders with the state sponsoring the Capco. For those states that require a share of distributions, the sharing percentages vary, but are generally from 10 to 30%, usually on distributions above a specified internal rate of return for the equity owners of the Capco. States not requiring distributions are Texas and New York (Programs 1, 2 and 3). At this time, Newtek does not believe that the sharing requirements will have a material impact on the company's financial condition or operations. Three of Newtek's Capcos have reached the 100% investment level and a fourth, our Wisconsin based Capco, met its statutory requirements and voluntarily decertified and was subsequently dissolved. While the Company continues to attempt to achieve full (100%) investment in all of its Capcos, circumstances of individual programs may make this unachievable. If and when such an event arises, the Capco and the Company will evaluate alternatives and may seek to dissolve the Capco as permitted under the particular program. Such an event would represent a failure of the Capco but would not carry with it any financial consequences to the Company.

## **Employees**

As of December 31, 2013, we and the companies in which we hold a controlling interest had a total of 319 employees, of which 314 were full-time employees. We believe our labor relations are good; none of our employees are covered by a collective bargaining agreement.

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### *Confidentiality Agreements*

All our employees have signed confidentiality agreements, and it is our standard practice to require newly hired employees and, when appropriate, independent consultants, to execute confidentiality agreements. These agreements provide that the employee or consultant may not use or disclose confidential information except in the performance of his or her duties for the Company, or in other limited circumstances. The steps taken by us may not, however, be adequate to prevent the misappropriation of our proprietary rights or technology.

### **Revenues and Assets by Geographic Area**

During the years ended December 31, 2013, 2012 and 2011, virtually all of our revenue was derived from customers in the United States, although we provide pre-paid web site hosting services to customers in approximately 120 countries.

### **Available Information**

We are subject to the informational requirements of the Securities Exchange Commission and in accordance with those requirements file reports, proxy statements and other information with the Securities and Exchange Commission. You may read and copy the reports, proxy statements and other information that we file with the Commission under the informational requirements of the Securities Exchange Act at the Commission's Public Reference Room at 450 Fifth Street N.W., Washington, DC 20549. Please call 1-800-SEC-0339 for information about the Commission's Public Reference Room. The Commission also maintains a web site that contains reports, proxy and information statements and other information regarding registrants that file electronically with the Commission. The address of the Commission's web site is <http://www.sec.gov>. Our principal offices are located at 212 West 39<sup>th</sup> Street, 2<sup>nd</sup> Floor, New York, NY, 10001 and our telephone number is (212) 356-9500. Our website may be directly accessed at <http://www.thesba.com>. We make available through our website, free of charge, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Commission. These documents may be directly accessed at <http://investor.newtekbusinessservices.com> Information contained on our website is not a part of this report.

### **Competition**

We compete in a large number of markets for the sale of services to small- and medium-sized businesses. Each of our principal operating companies competes not only against suppliers in its particular state or region of the country but also against suppliers operating on a national or even a multi-national scale. None of the markets in which our companies compete are dominated by a small number of companies that could materially alter the terms of the competition.

Our Electronic payment processing segment competes with entities including Heartland Payment Systems, First National Bank of Omaha, Jetpay Corporation (formerly Universal Business Payment Solutions) and Paymentech, L.P. Our Web hosting segment competes with 1&1, Hosting.com, Discount ASP, Maxum ASP, GoDaddy®, Yahoo!®, BlueHost®, iPowerWeb®, Rackspace.com, Web.com, Endurance International Group (EIGI) and Microsoft Live among others. Our Small Business Finance segment competes with regional and national banks and non-bank lenders. Intuit® is bundling electronic payment processing, web hosting and payroll services similar to ours in offerings that compete in the same small- to midsize-business market.



In many cases, we believe the competitors of our companies are not as able as we are to take advantage of changes in business practices due to technological developments and, for those with a larger size, are unable to offer the personalized service that many small business owners and operators seem to want.

While we compete with many different providers in our various businesses, we have been unable to identify any direct and comprehensive competitors that deliver the same broad suite of services focused on the needs of the small- and medium-sized business market with the same marketing strategy as we do. Some of our competitive advantages include:

Our compatible products such as our e-commerce offerings that we are able to bundle to increase sales, reduce costs and reduce risks for our customers and enable us to sell two, three, or four products at the same time;

Our proprietary NewTracker referral system, which allows us to process new business utilizing a web-based, centralized processing point and provides back end scalability;

Our focus on developing and marketing business services and financial products and services aimed at the small- and medium-sized business market;

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Our scalability, which allows us to size our business services capabilities very quickly to meet customer and market needs;

Our ability to offer personalized service and competitive rates;

A strategy of multiple channel distribution, which gives us maximum exposure in the marketplace;

High quality customer service 24x7x365 across all business lines, with a focus primarily on absolute customer service;

Our telephonic interview process, as opposed to requiring handwritten or data-typing processes, which allows us to offer high levels of customer service and satisfaction, particularly for small business owners who do not get this service from our competitors; and

Our NewTracker Portal, which allows our alliance partners to offer a centralized access point for their small- to medium-sized business clients as part of their larger strategic approach to marketing and allows such partners to demonstrate that they are focused on providing a suite of services to the small business market in addition to their core service.

## **ITEM 1 A. RISK FACTORS.**

The following is a summary of the risk factors that we believe are most relevant to our business. These are factors that, individually or in the aggregate, we think could cause our actual results to differ significantly from anticipated or historical results. *If any of the following risks occur, our business, financial condition and results of operations could be materially and adversely affected. In that case, the value of our common shares could decline and stockholders may lose all or part of their investment.* You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider the following to be a complete discussion of all potential risks or uncertainties. We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events, or otherwise, unless required by law.

### **RISKS RELATING TO OUR BUSINESS GENERALLY**

#### **Our success depends on our ability to compete effectively in the highly competitive and highly regulated industries in which we operate.**

We face intense competition in providing web hosting services, processing electronic payments and originating SBA loans, as well as in the other industries in which we or our affiliated companies operate. Low barriers to entry often result in a steady stream of new competitors entering certain of these businesses. Current and potential competitors are or may be better established, substantially larger and have more capital and other resources than we do. If we expand into additional geographical markets, we will face competition from others in those markets as well. In addition, some of the industries in which we operate are highly regulated and we cannot assure you that we will continue to be in full compliance with applicable laws, rules and regulations. Failure to maintain full compliance or if new laws limit or eliminate some of the benefits of our business lines, our financial condition, results of operations and cash flows could

be materially adversely affected.

**Our success depends upon our ability to enforce and maintain our intellectual property rights.**

Our success depends, in significant part, on the proprietary nature of our technology, including both patentable and non-patentable intellectual property related to our NewTracker referral system. We have filed one patent application with the United States Patent office but there can be no assurance that such patent will be granted. To the extent that a competitor is able to reproduce or otherwise capitalize on our technology, it may be difficult, expensive or impossible for us to obtain necessary legal protection. In addition to patent protection of intellectual property rights, we consider elements of our product designs and processes to be proprietary and confidential. We rely upon employee, consultant and vendor non-disclosure agreements and contractual provisions and a system of internal safeguards to protect our proprietary information. However, any of our registered or unregistered intellectual property rights may be challenged or exploited by others in the industry, which might harm our operating results. We have several trademarks and service marks which are of material importance to us. Litigation, which could result in substantial cost to and diversion of our efforts, may be necessary to enforce our trademarks or to determine the enforceability, scope and validity of the proprietary rights of others. Adverse determinations in any litigation or interference proceeding could subject us to costs related to changing brand names and a loss of established brand recognition.

**Our businesses depend on our ability to attract and retain key personnel and any loss of ability to attract these personnel could adversely affect us.**

Our success depends upon the ability of our affiliated companies and other companies in which we invest to attract and retain qualified personnel and our ability to supplement those capabilities with our senior management personnel. Competition for qualified employees is intense. If our affiliated companies lose the services of key personnel, or are unable to attract

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additional qualified personnel, the business, financial condition, results of operations and cash flows of us or one or more of our affiliated companies could be materially adversely affected. It can take a significant period of time to identify and hire personnel with the combination of skills and attributes required in carrying out our strategy.

Our business relies heavily on the expertise of our senior management. The loss of the services of these individuals could have a material adverse effect on our financial condition, results of operations and cash flows, and it is likely that it will be difficult to find adequate replacements.

**Our businesses depend upon the ability to utilize the Internet for the conduct of a significant portion of their business; disruption to that system could make it impossible for them to continue to conduct their current businesses.**

Possible disruption to the normal functioning of the Internet through, for example, power failure or terrorist sabotage, could make it impossible for aspects of the lending, electronic payment processing, web hosting and in fact our referral system to function. In the event of a major disruption, and assuming that such disruptions would be long-lived, we would be required to make extensive changes in the way these companies do business. There is no assurance that we will have the time and resources to make these changes.

**Our success depends on our ability to use effectively our electronic referral and information processing systems.**

We have developed an electronic referral and processing system for the applications necessary for the sales of each of our business lines other than web site hosting. This system is critical to our ability to process such business with a low cost advantage and to obtain referrals from our alliance partners. In particular, the ability to access the referral system and to track the progress of a referred customer is a major feature of the perceived attractiveness of our system. If this referral system should develop problems which we cannot address, it would have a material negative impact on our business strategy. In addition, our ability to provide business services increasingly depends on our capacity to store, retrieve, process and manage significant amounts of data. Interruption or loss of our information processing capabilities through loss of stored data, breakdown or malfunctioning of computer equipment and software systems, telecommunications failure or damage caused by acts of nature or other disruption, could have a material adverse effect on our business, financial condition, results of operations and cash flows.

## **RISKS RELATING TO OUR ELECTRONIC PAYMENT PROCESSING BUSINESS**

**NMS relies on a bank sponsor, which has substantial discretion with respect to certain elements of our business practices, in order to process bankcard transactions. If the sponsorship is terminated, and we are not able to secure or transfer the respective merchant portfolio to a new bank sponsor or sponsors, the business, financial condition, results of operations and cash flows of electronic payment processing business could be materially adversely affected. If the sponsorship is terminated, and we are not able to secure or transfer the merchant portfolios to new bank sponsors, we will not be able to conduct our electronic payment processing business. We also rely on service providers who are critical to our business.**

Because we are not a bank, we are unable to belong to and directly access the Visa® and MasterCard® bankcard associations. The Visa® and MasterCard® operating regulations require us to be sponsored by a bank in order to process bankcard transactions. We are currently sponsored by two banks. If the sponsorship is terminated and we are unable to secure a bank sponsor for the merchant portfolios, we will not be able to process bankcard transactions for the affected portfolios. Consequently, the loss of both of our sponsorships would have a material adverse effect on our business. Furthermore, our agreement with our sponsoring banks gives the sponsoring banks substantial discretion in

approving certain elements of our business practices, including our solicitation, application and qualification procedures for merchants, the terms of our agreements with merchants, the processing fees that we charge, our customer service levels and our use of independent sales organizations and independent sales agents. We cannot guarantee that our sponsoring banks' actions under these agreements will not be detrimental to us.

Other service providers, some of whom are our competitors, are necessary for the conduct of our business. The termination by our service providers of these arrangements with us or their failure to perform these services efficiently and effectively may adversely affect our relationships with the merchants whose accounts we serve and may cause those merchants to terminate their processing agreements with us.

**If NMS or its processors or bank sponsors fail to adhere to the standards of the Visa® and MasterCard® bankcard associations, our registrations with these associations could be terminated and we could be required to stop providing payment processing services for Visa® and MasterCard®.**

Substantially all of the transactions NMS processes involve Visa® or MasterCard®. If we, our bank sponsors or our processors fail to comply with the applicable requirements of the Visa® and MasterCard® bankcard associations, Visa® or

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MasterCard® could suspend or terminate our registration. The termination of our registration or any changes in the Visa® or MasterCard® rules that would impair our registration could require us to stop providing payment processing services, which would have a material adverse effect on our business.

**On occasion, NMS experiences increases in interchange and sponsorship fees. If we cannot pass along these increases to our merchants, our profit margins will be reduced.**

Our electronic payment processing subsidiary pays interchange fees or assessments to bankcard associations for each transaction we process using their credit, debit and gift cards. From time to time, the bankcard associations increase the interchange fees that they charge processors and the sponsoring banks, which generally pass on such increases to us. From time to time, our sponsoring banks increase their fees as well. If we are not able to pass these fee increases along to merchants through corresponding increases in our processing fees, our profit margins in this line of business will be reduced.

**Unauthorized disclosure of merchant or cardholder data, whether through breach of our computer systems or otherwise, could expose us to liability and business losses.**

Through our electronic payment processing subsidiary, we collect and store sensitive data about merchants and cardholders, and we maintain a database of cardholder data relating to specific transactions, including payment, card numbers and cardholder addresses, in order to process the transactions and for fraud prevention and other internal processes. If anyone penetrates our network security or otherwise misappropriates sensitive merchant or cardholder data, we could be subject to liability or business interruption. While we subject these systems to periodic independent testing and review, we cannot guarantee that our systems will not be penetrated in the future. If a breach of our system occurs, we may be subject to liability, including claims for unauthorized purchases with misappropriated card information, impersonation or other similar fraud claims. Similar risks exist with regard to the storage and transmission of such data by our processors. In the event of any such a breach, we may also be subject to a class action lawsuit. Small businesses are less prepared for the complexities of safeguarding cardholder data than their larger counterparts. In the event of noncompliance by a customer of card industry rules, we could face fines from payment card networks. There can be no assurance that we would be able to recover any such fines from such customer.

**NMS is liable if our processing merchants refuse or cannot reimburse charge-backs resolved in favor of their customers.**

If a billing dispute between a merchant and a cardholder is not ultimately resolved in favor of the merchant, the disputed transaction is charged back to the merchant's bank and credited to the account of the cardholder. If we or our processing banks are unable to collect the charge-back from the merchant's account, or if the merchant refuses or is financially unable due to bankruptcy or other reasons to reimburse the merchant's bank for the charge-back, we bear the loss for the amount of the refund paid to the cardholder's bank. Most of our merchants deliver products or services when purchased, so a contingent liability for charge-backs is unlikely to arise, and credits are issued on returned items. However, some of our merchants do not provide services until sometime after a purchase, which increases the potential for contingent liability and future charge backs. We and the sponsoring bank can require that merchants maintain cash reserves under our control to cover charge back liabilities but such reserves may not be sufficient to cover the liability or may not even be available to us in the event of a bankruptcy or other legal action.

**NMS has potential liability for customer or merchant fraud.**

Credit card fraud occurs when a merchant's customer uses a stolen card (or a stolen card number in a card-not-present transaction) to purchase merchandise or services. In a traditional card-present transaction, if the merchant swipes the

card, receives authorization for the transaction from the card issuing bank and verifies the signature on the back of the card against the paper receipt signed by the customer, the card issuing bank remains liable for any loss. In a fraudulent card-not-present transaction, even if the merchant receives authorization for the transaction, the merchant is liable for any loss arising from the transaction. Many of our business customers are small and transact a substantial percentage of their sales over the Internet or by telephone or mail orders. Because their sales are card-not-present transactions, these merchants are more vulnerable to customer fraud than larger merchants, and we could experience charge-backs arising from cardholder fraud more frequently with these merchants.

Merchant fraud occurs when a merchant, rather than a customer, knowingly uses a stolen or counterfeit card or card number to record a false sales transaction or intentionally fails to deliver the merchandise or services sold in an otherwise valid transaction. Anytime a merchant is unable to satisfy a charge-back, we are responsible for that charge-back unless we have required that a cash reserve be established. We cannot assure that the systems and procedures we have established to detect and reduce the impact of merchant fraud are or will be effective. Failure to effectively manage risk and prevent fraud could increase our charge-back liability and adversely affect our results of operations.

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### **Our payment processing systems may fail due to factors beyond our control, which could interrupt our business or cause us to lose business and likely increase our costs.**

We depend on the uninterrupted operations of our computer network systems, software and our processors' data centers. Defects in these systems or damage to them due to factors beyond our control could cause severe disruption to our business and other material adverse effects on our payment processing businesses.

### **RISKS RELATING TO OUR BUSINESS OF WEBSITE HOSTING**

#### **NTS operates in a highly competitive industry in which technological change can be rapid.**

The information technology business and its related technology involve a broad range of rapidly changing technologies. Our equipment and the technologies on which it is based may not remain competitive over time, and others may develop superior technologies that render our products non-competitive without significant additional capital expenditures. Some of our competitors are significantly larger and have substantially greater market presence as well as greater financial, technical, operational, marketing and other resources and experience than we do. In the event that such a competitor expends significant sales and marketing resources in one or several markets, we may not be able to compete successfully in such markets. We believe that competition will continue to increase, placing downward pressure on prices. Such pressure could adversely affect our gross margins if we are not able to reduce our costs commensurate with such price reductions. There can be no assurances that we will remain competitive.

#### **Our website hosting business depends on the efficient and uninterrupted operation of its computer and communications hardware systems and infrastructure.**

Despite precautions taken by NTS against possible failure of its systems, interruptions could result from natural disasters, power loss, the inability to acquire fuel for our backup generators, telecommunications failure, terrorist attacks and similar events. NTS also leases telecommunications lines from local, regional and national carriers whose service may be interrupted. Our business, financial condition and results of operations could be harmed by any damage or failure that interrupts or delays our operations. There can be no assurance that our insurance will cover all of the losses or compensate NTS for the possible loss of clients occurring during any period that NTS is unable to provide service.

#### **Our inability to maintain the integrity of our infrastructure and the privacy of confidential information would materially affect our business.**

The NTS infrastructure is potentially vulnerable to physical or electronic break-ins, viruses or similar problems. If our security measures are circumvented, it could jeopardize the security of confidential information stored on NTS's systems, misappropriate proprietary information or cause interruptions in NTS's operations. We may be required to make significant additional investments and efforts to protect against or remedy security breaches. Security breaches that result in access to confidential information could damage our reputation and expose us to a risk of loss or liability. The security services that NTS offers in connection with customers' networks cannot assure complete protection from computer viruses, break-ins and other disruptive problems. The occurrence of these problems may result in claims against NTS or us or liability on our part. These claims, regardless of their ultimate outcome, could result in costly litigation and could harm our business and reputation and impair NTS's ability to attract and retain customers.

#### **Our business depends on Microsoft Corporation and others for the licenses to use software as well as other intellectual property in the website hosting business.**



NTS's managed technology business is built on technological platforms relying on the Microsoft Windows® products and other intellectual property that NTS currently licenses. As a result, if we are unable to continue to have the benefit of those licensing arrangements or if the products upon which NTS's platform is built become obsolete, our business could be materially and adversely affected.

## **RISKS RELATING TO OUR SMALL BUSINESS FINANCE BUSINESSES**

### **We depend on outside financing.**

Our SBA lending and receivables financing businesses depend on outside financing to support their loan making and acquisition of receivables. Termination of the credit lines for any reason would have a material adverse effect on our business, including but not limited to, the liquidation of the guaranteed loan and receivables portfolios to pay down the lines. If funds from such sale were insufficient to completely pay down the line of credit, the holding company and certain of its subsidiaries would be responsible for any short fall. In December 2010 and again in December 2011 and 2013, the Company securitized a portion of its unguaranteed, retained loan portions of its SBA 7(a) loans; the Company anticipates using securitizations to ultimately fund future loan creation, assuming the market for such securitizations continues to exist and

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future securitizations can be executed on an economic basis beneficial to the Company. Although a securitization potentially provides a long term funding source for the Company's SBA lender, it does not provide liquidity in the short term for funding SBA loans. Because its resources will be insufficient to maintain current SBA loan originations, failure of our SBA lender to arrange a line to fund and warehouse the origination of unguaranteed, retained loan portions would materially impact our business. In addition, our receivables financing company depends on a line of credit which has been extended to mature in February 2016. Loss of this line and our inability to replace it would materially impact the business.

### **We have specific risks associated with Small Business Administration (SBA) loans.**

We have generally sold the guaranteed portion of SBA loans in the secondary market. Such sales have resulted in our earning premiums and creating a stream of servicing income. There can be no assurance that we will be able to continue originating these loans, or that a secondary market will exist for, or that we will continue to realize premiums upon the sale of the guaranteed portions of the SBA 7(a) loans.

Since we sell the guaranteed portion of substantially our entire SBA 7(a) loan portfolio, we incur credit risk on the non-guaranteed portion of the SBA loans. We share pro rata with the SBA in any recoveries. In the event of default on an SBA loan, our pursuit of remedies against a borrower is subject to SBA approval, and where the SBA establishes that its loss is attributable to deficiencies in the manner in which the loan application has been prepared and submitted, the SBA may decline to honor its guarantee with respect to our SBA loans or it may seek the recovery of damages from us. If we should experience significant problems with our underwriting of SBA loans, such failure to honor a guarantee or the cost to correct the problems could have a material adverse effect on us. Although the SBA has never declined to honor its guarantees with respect to SBA loans made by us since our acquisition of the lender in 2003, no assurance can be given that the SBA would not attempt to do so in the future.

### **Curtailed of the government-guaranteed loan programs could cut off an important segment of our business.**

Although the program has been in existence since 1953, there can be no assurance that the federal government will maintain the SBA program, or that it will continue to guarantee loans at current levels. If we cannot continue making and selling government-guaranteed loans, we will generate fewer origination fees and our ability to generate gains on sale of loans will decrease. From time-to-time, the government agencies that guarantee these loans reach their internal budgeted limits and cease to guarantee loans for a stated time period. In addition, these agencies may change their rules for loans. Also, Congress may adopt legislation that would have the effect of discontinuing or changing the programs. Non-governmental programs could replace government programs for some borrowers, but the terms might not be equally acceptable. If these changes occur, the volume of loans to small business and industrial borrowers of the types that now qualify for government-guaranteed loans could decline, as could the profitability of these loans.

### **An increase in non-performing assets would reduce our income and increase our expenses.**

If our level of non-performing assets in our SBA lending and receivable financing businesses rise in the future, it could adversely affect our revenue and earnings. Non-performing assets are primarily loans on which borrowers are not making their required payments or receivables for which the customer has not made timely payment. Non-performing assets also include loans that have been restructured to permit the borrower to have smaller payments and real estate that has been acquired through foreclosure of unpaid loans. To the extent that our financial assets are non-performing, we will have less cash available for lending and other activities.

### **Our reserve for credit losses may not be sufficient to cover unexpected losses.**

Our business depends on the behavior of our customers. In addition to our credit practices and procedures, we maintain a reserve for credit losses on our SBA loans and accounts receivable portfolio, which management has judged to be adequate given the loans we originate and receivables we purchase. We periodically review our reserve for adequacy considering current economic conditions and trends, collateral values, charge-off experience, levels of past due loans and non-performing assets, and we adjust our reserve accordingly. However, because of the poor current economic conditions caused by the recession, our reserves may prove inadequate, which could have a material adverse effect on our financial condition and results of operations.

**We could be adversely affected by weakness in the residential housing and commercial real estate markets.**

Continued weakness in residential home and commercial real estate values could impair our ability to collect on defaulted SBA loans as real estate is pledged in many of our SBA loans as part of the collateral package.

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**RISKS RELATING TO OUR INSURANCE AGENCY BUSINESS**

**We depend on third parties, particularly property and casualty insurance companies, to supply the products marketed by our agents.**

Our contracts with property and casualty insurance companies typically provide that the contracts can be terminated by the supplier without cause. Our inability to enter into satisfactory arrangements with these suppliers or the loss of these relationships for any reason would adversely affect the results of our new insurance business. Also, our inability to obtain these products at competitive prices could make it difficult for us to compete with larger and better capitalized providers of such insurance services.

**If we fail to comply with government regulations, our insurance agency business could be adversely affected.**

Our insurance agency business is subject to comprehensive regulation in the various states in which we plan to conduct business. Our success will depend in part upon our ability to satisfy these regulations and to obtain and maintain all required licenses and permits. Our failure to comply with any statutes and regulations could have a material adverse effect on us. Furthermore, the adoption of additional statutes and regulations, changes in the interpretation and enforcement of current statutes and regulations or the expansion of our business into jurisdictions that have adopted more stringent regulatory requirements than those in which we currently conduct business could have a material adverse effect on us.

**We do not have any control over the commissions our insurance agency expects to earn on the sale of insurance products which are based on premiums and commission rates set by insurers and the conditions prevalent in the insurance market.**

Our insurance agency earns commissions on the sale of insurance products. Commission rates and premiums can change based on the prevailing economic and competitive factors that affect insurance underwriters. In addition, the insurance industry has been characterized by periods of intense price competition due to excessive underwriting capacity and periods of favorable premium levels due to shortages of capacity. We cannot predict the timing or extent of future changes in commission rates or premiums or the effect any of these changes will have on the operations of our insurance agency.

**RISKS RELATING TO OUR PAYROLL PROCESSING BUSINESS**

**Unauthorized disclosure of employee data, whether through breach of our computer systems or otherwise, could expose us to liability and business losses.**

Through our payroll processing subsidiary, we collect and store sensitive data about individuals, in order to process the transactions and for other internal processes. If anyone penetrates our network security or otherwise misappropriates sensitive individual data, we could be subject to liability or business interruption. While we subject these systems to periodic independent testing and review, we cannot guarantee that our systems will not be penetrated in the future. If a breach of our system occurs, we may be subject to liability, including claims for impersonation or other similar fraud claims. In the event of any such a breach, we may also be subject to a class action lawsuit. Any significant violations of data privacy could result in the loss of business, litigation and regulatory investigations and penalties that could damage our reputation, and the growth of our business could be adversely affected.

**Our systems may be subject to disruptions that could adversely affect our business and reputation.**

Our payroll business relies heavily on our payroll, financial, accounting and other data processing systems. If any of these systems fails to operate properly or becomes disabled even for a brief period of time, we could suffer financial loss, a disruption of our business, liability to clients, regulatory intervention or damage to our reputation. We have disaster recovery plans in place to protect our businesses against natural disasters, security breaches, military or terrorist actions, power or communication failures or similar events. Despite our preparations, our disaster recovery plans may not be successful in preventing the loss of client data, service interruptions, and disruptions to our operations or damage to our important facilities.

**If we fail to adapt our technology to meet client needs and preferences, the demand for our services may diminish.**

Our businesses operate in industries that are subject to rapid technological advances and changing client needs and preferences. In order to remain competitive and responsive to client demands, we continually upgrade, enhance and expand our existing solutions and services. If we fail to respond successfully to technology challenges, the demand for our services may diminish.

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### **Our payroll business could incur unreimbursed costs or damages due to delays in processing inherent in the banking system.**

Our payroll processing business generally determines the availability of customer (employer) funds prior to making payments to employees or taxing authorities, and such employer funds are generally transferred in to our accounts prior to making payments out. Due to the structure of the banking system however, there are times when we may make payroll or tax payments and not immediately receive the funds to do so from the employer. There can be no assurance that the procedures we have in place to prevent these occurrences or mitigate the damages will be sufficient to prevent loss to our business.

### **RISKS RELATED TO OUR CAPCO BUSINESS**

**The Capco programs and the tax credits they provide are created by state legislation and implemented through regulation, and such laws and rules are subject to possible action to repeal or retroactively revise the programs for political, economic or other reasons. Such an attempted repeal or revision would create substantial difficulty for the Capco programs and could, if ultimately successful, cause us material financial harm.**

The tax credits associated with the Capco programs and provided to our Capcos' investors are to be utilized by the investors over a period of time, which is typically ten years. Much can change during such a period and it is possible that one or more states may revise or eliminate the tax credits. Any such revision or repeal could have a material adverse economic impact on our Capcos, either directly or as a result of the Capco's insurer's actions. Any such final state action that jeopardizes the tax credits could result in the provider of our Capco insurance assuming partial or full control of the particular Capco in order to minimize its liability under the Capco insurance policies issued to our investors.

During 2002, a single legislator in Louisiana introduced such a proposed bill, on which no action was taken, and in Colorado in 2003 and 2004 bills to modify (not repeal) its Capco program were introduced; the 2003 Colorado legislation was defeated in a legislative committee. The 2004 Colorado legislation was adopted but implementing regulations made clear the application of the new rules only to investments made after passage. There can be no assurance that we will not be subject to further legislative or regulatory action which might adversely impact our Capco business, or that we will be able to successfully challenge any such action.

**Because our Capcos are subject to requirements under state law, a failure of any of them to meet these requirements could subject the Capco and our stockholders to the loss of one or more Capcos.**

Despite the fact that we have met all applicable minimum requirements of the Capco programs in which we still participate, each Capco remains subject to state regulation until it has invested 100 percent of its funds and otherwise remained in full legal compliance. There can be no assurance that we will continue to be able to do so. A major regulatory violation, while not fatal to our Capco business, would materially increase the cost of operating the Capcos.

### **RISKS RELATING TO OUR COMMON SHARES**

**Our shares may be delisted.**

If we do not continue to meet the requirements for continued listing on the NASDAQ Capital Market our common shares could be delisted. One such requirement is maintaining a minimum bid price for shares of \$1.00. As compliance with the minimum trading price for common shares is beyond our control, there can be no assurance that the price will remain above \$1.00 indefinitely and, therefore, no assurance that the threat of delisting can be avoided.

In the event that the common shares are delisted, there can be no assurance that an active public market for our shares can be sustained or that current trading levels can be sustained or not diminished.

**The application of the penny stock rules to our common shares if we are no longer listed on the NASDAQ Capital Market could limit the trading and liquidity of the common shares, adversely affect the market price of our Common Shares and increase your transaction costs to sell those shares.**

If we are no longer listed on the NASDAQ Capital Market, as long as the trading price of our common shares is below \$5.00 per share, open-market trading will be subject to the penny stock rules, which impose additional sales practice requirements on broker-dealers who sell securities to persons other than established customers and accredited investors and otherwise have the effect of limiting the trading activity of the common shares, reducing the liquidity of an investment in the common shares and increasing the transaction costs for their sales and purchases.

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**Two of our stockholders, one a current and one a former executive officer, beneficially own approximately 24% of our common shares, and are able to exercise significant influence over the outcome of most stockholder actions.**

Although there is no agreement or understanding between them, because of their ownership of our shares, Messrs. Sloane and Rubin will be able to have significant influence over actions requiring stockholder approval, including the election of directors, the adoption of amendments to the certificate of incorporation, approval of stock incentive plans and approval of major transactions such as a merger or sale of assets. This could delay or prevent a change in control of our company, deprive our stockholders of an opportunity to receive a premium for their common shares as part of a change in control and have a negative effect on the market price of our common shares.

**Future issuances of our common shares or other securities, including preferred shares, may dilute the per share book value of our common shares or have other adverse consequences to our common stockholders.**

Our board of directors has the authority, without the action or vote of our stockholders, to issue all or part of the approximately 19,000,000 authorized but unissued shares of our common stock. Our business strategy relies upon investments in and acquisitions of businesses using the resources available to us, including our common shares. We have made acquisitions during each of the years from 2002 to 2005 involving the issuance of our common shares and we expect to make additional acquisitions in the future using our common shares. Additionally, we anticipate granting additional options or restricted stock awards to our employees and directors in the future. We may also issue additional securities, through public or private offerings, in order to raise capital to support our growth, including in connection with possible acquisitions or in connection with purchases of minority interests in affiliated companies or Capcos. Future issuances of our common shares will dilute the percentage of ownership interest of current stockholders and could decrease the per share book value of our common shares. In addition, option holders may exercise their options at a time when we would otherwise be able to obtain additional equity capital on more favorable terms.

Pursuant to our certificate of incorporation, our board of directors is authorized to issue, without action or vote of our stockholders, up to 1,000,000 shares of blank check preferred shares, meaning that our board of directors may, in its discretion, cause the issuance of one or more series of preferred shares and fix the designations, preferences, powers and relative participating, optional and other rights, qualifications, limitations and restrictions thereof, including the dividend rate, conversion rights, voting rights, redemption rights and liquidation preference, and to fix the number of shares to be included in any such series. The preferred shares so issued may rank superior to the common shares with respect to the payment of dividends or amounts upon liquidation, dissolution or winding-up, or both. In addition, the shares of preferred stock may have class or series voting rights.

**The authorization and issuance of blank check preferred shares could have an anti-takeover effect detrimental to the interests of our stockholders.**

Our certificate of incorporation allows our board of directors to issue preferred shares with rights and preferences set by the board without further stockholder approval. The issuance of these blank check preferred shares could have an anti-takeover effect detrimental to the interests of our stockholders. For example, in the event of a hostile takeover attempt, it may be possible for management and the board to impede the attempt by issuing the preferred shares, thereby diluting or impairing the voting power of the other outstanding common shares and increasing the potential costs to acquire control of us. Our board has the right to issue any new shares, including preferred shares, without first offering them to the holders of common shares, as they have no preemptive rights.



**We know of no other publicly-held company that sponsors and operates Capcos as a material part of its business. As such, there are, to our knowledge, no other companies against which investors may compare our Capco business segment, and its operations, results of operations and financial and accounting structures.**

In the absence of any meaningful peer group comparisons for our Capco business, investors may have a difficult time understanding and judging the strength of our business. This, in turn, may have a depressing effect on the value of our shares.

**Provisions of our certificate of incorporation and New York law place restrictions on our stockholders' ability to recover from our directors for breaches of their duties.**

As permitted by New York law, our amended and restated certificate of incorporation limits the liability of our directors for monetary damages for breach of a director's fiduciary duty except for liability in certain instances. As a result of these provisions and New York law, stockholders have restrictions and limitations upon their rights to recover from directors for breaches of their duties. In addition, our certificate of incorporation provides that we must indemnify our directors and officers to the fullest extent permitted by law.

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**Failure to maintain effective internal controls over financial reporting may lead investors and others to lose confidence in our financial data.**

In evaluating the effectiveness of its internal controls over financial reporting in connection with the preparation of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, management concluded that there was a material weakness in internal control over financial reporting related to accounting for one bank account holding funds belonging to customers of our merchant processing subsidiary. These material weaknesses made it possible for a former senior manager to utilize funds in this account to conceal knowledge of growing merchant processing chargeback losses among a group of merchants solicited by one of the Company's agents. Following discovery, this resulted in the need for the restatement of the Company's financial statements for the year ended December 31, 2011, together with financial statements for the quarters ended March 31, 2012, June 30, 2012 and September 30, 2012, the periods over which these losses occurred.

The Company has remediated these material weaknesses and has, among other things, replaced the manager responsible, strengthened its internal control team by hiring a very seasoned Chief Risk Officer, augmented its finance team and has implemented and modified certain accounting and internal control procedures. If the Company fails to otherwise maintain effective controls over financial reporting in the future, it could again result in a material misstatement of its financial statements that might not be prevented or detected on a timely basis and which could then cause investors and others to lose confidence in the Company's financial statements, which in turn could have a negative effect on the value of the Company's equity securities.

**ITEM 1B. UNRESOLVED STAFF COMMENTS.**

Not applicable.

**Table of Contents****ITEM 2. PROPERTIES.**

We conduct our principal business activities in facilities leased from unrelated parties at market rates. Our headquarters are located in New York, New York. Our operating subsidiaries have properties which are material to the conduct of their business as noted below. In addition, our Capcos maintain offices in each of the states in which they operate.

Below is a list of our leased offices and space as of December 31, 2013 which are material to the conduct of our business:

| <b>Location</b>  | <b>Lease expiration</b> | <b>Purpose</b>  | <b>Approx. sq. ft</b> |
|--|-------------------------|---|-----------------------|
| 8521 E. Princess Drive<br>Phoenix, AZ 85255                | Jun 2014                | Managed technology solutions data center  | 6,000                 |
| 212 West 35 <sup>th</sup> Street<br>New York, NY 10001     | Oct 2014                | Lease of principal executive offices (Corporate activities and SBA lending)             | 5,700                 |
| 7920 Belt Line Road<br>Suite: 1150<br>Richardson, TX 75254 | Dec 2014                | Electronic payment processing TX offices  | 3,600                 |
| 1904 West Parkside Lane<br>Suite 201<br>Phoenix, AZ 85027  | Feb 2015                | Managed technology solutions offices  | 10,900                |
| 4 Park Plaza<br>Irvine, CA 92614                           | Feb 2015                | Newtek Small Business Finance offices   | 3,300                 |
| 1440 Broadway<br>New York, New York 10018                  | Oct 2015                | Sublet - former principal executive offices   | 23,000                |
| 301 Mexico Street<br>Suite H3-A<br>Brownsville, TX 78520   | Jun 2017                | Newtek Insurance Agency, customer service and sales support offices (All Other segment) | 17,500                |
| 6737 W. Washington St.<br>Suite 2275                       | Nov 2017                | Electronic payment processing WI offices  | 10,910                |

West Allis, WI 53214

|                          |          |  |        |
|--------------------------|----------|--|--------|
| 60 Hempstead Avenue      | Apr 2019 | Newtek Small Business Finance; Newtek Business Credit Offices (Lending segment) and NY Capco offices | 22,000 |
| West Hempstead, NY 11552 |          |  |        |

We believe that our leased facilities are adequate to meet our current needs and that additional facilities are available to meet our development and expansion needs in existing and projected target markets.

**ITEM 3. LEGAL PROCEEDINGS.**

In the ordinary course of business, the Company may from time to time be party to lawsuits and claims. The Company evaluates such matters on a case by case basis and its policy is to contest vigorously any claims it believes are without compelling merit. The Company is currently involved in various litigation matters. Management has reviewed all legal claims against the Company with counsel and has taken into consideration the views of such counsel, as to the outcome of the claims. In management’s opinion, final disposition of all such claims will not have a material adverse effect on the results of operations, cash flows or financial position of the Company.

**ITEM 4. MINE SAFETY DISCLOSURES.**

Not applicable.

**Table of Contents****PART II****ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

(a) Market Information: Our common stock is traded on the NASDAQ Capital Market under the symbol NEWT. High and low prices for the common stock over the previous two years are set forth below, based on the highest and lowest daily closing price during that period.

| <b>Period</b>   | <b>High</b> | <b>Low</b> |
|---|-------------|------------|
| First Quarter: January 1, 2012 Through March 31, 2012     | \$ 1.60     | \$ 1.18    |
| Second Quarter: April 1, 2012 Through June 30, 2012       | \$ 1.62     | \$ 1.14    |
| Third Quarter: July 1, 2012 Through September 30, 2012    | \$ 2.09     | \$ 1.24    |
| Fourth Quarter: October 1, 2012 Through December 31, 2012 | \$ 2.05     | \$ 1.76    |
| First Quarter: January 1, 2013 Through March 31, 2013     | \$ 2.18     | \$ 1.80    |
| Second Quarter: April 1, 2013 Through June 30, 2013       | \$ 2.20     | \$ 2.02    |
| Third Quarter: July 1, 2013 Through September 30, 2013    | \$ 3.04     | \$ 2.07    |
| Fourth Quarter: October 1, 2013 Through December 31, 2013 | \$ 3.14     | \$ 2.58    |

Holders: As of March 17, 2014 there were approximately 172 holders of record of our common stock.

Dividends: No dividends were declared or paid in 2011, 2012 or 2013.

Securities authorized for issuance under equity compensation plans:

| <b>Plan Category</b>                                       | <b>(a)<br/>Number of securities to<br/>be issued upon exercise<br/>of outstanding options,<br/>warrants<br/>and rights</b> | <b>(b)<br/>Weighted-average<br/>exercise price<br/>of<br/>outstanding options,<br/>warrants and<br/>rights</b> | <b>(c)<br/>Number of securities<br/>remaining available for<br/>future issuance under<br/>equity compensation<br/>plans<br/>(excluding<br/>securities<br/>reflected in column<br/>(a))</b> |
|--|--|--|--|
| Equity compensation plans approved by security holders     | 2,094,970 shares   | \$ 1.45/share  | 3,081,068 shares   |
| Equity compensation plans not approved by security holders | None   | None   | None   |

(b) Not applicable.

(c) Not applicable.

**ITEM 6. SELECTED FINANCIAL DATA.**

Not applicable.

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

**Introduction and Certain Cautionary Statements**

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

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

*We also need to point out that our Capcos operate under a different set of rules in each of the six jurisdictions and that these place varying requirements on the structure of our investments. In some cases, particularly in Louisiana, we do not control the equity or management of a qualified business.*

**Executive Overview**

For the year ended December 31, 2013, the Company recorded net income of \$7,151,000 on revenues of \$143,593,000. Net income improved by \$1,594,000, from net income of \$5,557,000 in 2012; pretax income was \$11,069,000, a \$1,630,000 improvement over the \$9,439,000 pretax income in 2012. Total revenues increased by \$12,463,000, or 9.5%, from \$131,130,000 for the year ended December 31, 2012 principally due to increased revenues in the Small business finance and Electronic payment processing segments. Total expenses increased by \$10,749,000 to \$131,319,000 for the year ended 2013 from \$120,570,000 for 2012 primarily due to increases in electronic payment processing costs, other general and administrative costs, and salaries and benefits.

Contributing to the pretax income of \$11,069,000 in 2013 were improvements in the Electronic payment processing, Small business finance and Capco segments, which were offset by a decrease in pretax income for Managed technology solutions and increased pretax losses in the All Other and Corporate segments. The Electronic payment processing segment gross margin decreased nominally on a percentage basis, primarily due to competitive pricing for our larger volume merchants. This decline was offset in part by an increase in margin due to a reduction in the provision for chargebacks. The improvement in the Capco segment pretax income resulted from reductions in interest expense and management fees, which more than offset the decrease in income from tax credits recorded in the current period.

One of the primary contributors to Newtek's continued profitability was the Small business finance segment which generated pretax income of \$10,143,000 compared to \$8,094,000 in 2012, an increase of \$2,049,000. The primary driver was premium income on sales of guaranteed loan portions which increased by \$7,089,000, or 57% over the year ago period. The number of loans sold during 2013 increased to 167 with a corresponding dollar volume of \$131,733,000, from 105 loans sold totaling \$84,743,000 in dollar volume for the year ago period. Total SBA loans originated increased to \$177,941,000 in 2013 compared with \$107,425,000 for 2012. The weighted average sales price for the guaranteed portions of SBA loans sold increased slightly to 112.32% compared with 112.22% for 2013

and 2012, respectively.

The Electronic payment processing segment recorded an 18% increase in pretax net income, which grew to \$8,304,000 from \$7,041,000 compared with the year ago period. Revenue increased by \$4,166,000 or 5% to \$89,655,000 during 2013 compared to 2012. The increase was related to growth in processing volumes and fee increases passed on to merchants. Processing revenue less processing costs remained essentially stable, decreasing slightly from 15.6% to 15.5% in 2013. While margin was favorably impacted by the reduction in provision for chargebacks in 2013 compared with the year ago period, this decrease was offset by the continued trend in lower merchant pricing due to competitive pressure.

Pretax net income for Managed technology solutions decreased from \$4,254,000 to \$3,564,000 for the year ended December 31, 2013. While segment revenue decreased by 3% due primarily to a reduction in web hosting, we saw an increase in our total revenue related to web design, and we saw continued growth in the number of customers using our cloud computing services as well as an increase in the average revenue per plan compared with the year ago period. It continues to be management's intent to increase revenue and margin per plan through higher service offerings to customers which include cloud-based applications.



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In March and December 2013, a Company subsidiary closed its third and fourth securitizations issuing an additional \$20,909,000 and \$24,433,000, respectively, in notes with an A rating under S&P; see Securitization Transactions in Part II Item 7.

Also during 2013, Exponential of New York, LLC, one of the Company's Capcos, made investments which when aggregated with prior investments equal 100% of its certified capital under the provisions of the New York Certified Capital Company Act. Notice of reaching this investment level was provided to New York State and the Capco is pending examination by the State to confirm this investment level, at which time it will cease to be regulated as a certified capital company. Thereafter, the managers of the Company will determine the optimum strategy for liquidation of the entity.

**Table of Contents****Business Segment Results:**

The results of the Company's reportable business segments are discussed below.

**Electronic Payment Processing**

| (In thousands):                        | 2013      | 2012      | 2011      | % Change |       |
|--|-----------|-----------|-----------|----------|-------|
|  |           |           |           | 2013     | 2012  |
| <b>Revenue:</b>                        |           |           |           |          |       |
| Electronic payment processing          | \$ 89,651 | \$ 85,483 | \$ 82,475 | 5%       | 4%    |
| Interest income                        | 4         | 6         | 11        | (33)%    | (46)% |
| Total revenue                          | 89,655    | 85,489    | 82,486    | 5%       | 4%    |
| <b>Expenses:</b>                       |           |           |           |          |       |
| Electronic payment processing costs    | 75,761    | 72,183    | 69,388    | 5%       | 4%    |
| Salaries and benefits                  | 3,485     | 3,991     | 3,995     | (13)%    | %     |
| Professional fees                      | 458       | 323       | 270       | 42%      | 20%   |
| Depreciation and amortization          | 358       | 743       | 1,419     | (52)%    | (48)% |
| Insurance expense related party        | 57        | 61        | 51        | (7)%     | 20%   |
| Other general and administrative costs | 1,232     | 1,147     | 1,206     | 7%       | (5)%  |
| Total expenses                         | 81,351    | 78,448    | 76,329    | 4%       | 3%    |
| Income before income taxes             | \$ 8,304  | \$ 7,041  | \$ 6,157  | 18%      | 14%   |

**2013**

EPP revenue increased \$4,168,000 or 5% between years, primarily due to growth in processing volumes and the effect of card association fee increases passed through to merchants. Processing volumes were favorably impacted by a 1% increase in the average number of processing merchants under contract between periods and an increase of approximately 6% in the average monthly processing volume per merchant. The increase in the average monthly processing volume per merchant is due in part to the addition of several larger volume processing merchants as well as year-over-year growth in processing volumes from existing merchants. This overall increase in revenue between years was partially offset by lower average pricing between years due to competitive pricing considerations, particularly for larger processing volume merchants with lower revenue per transaction, between periods.

Electronic payment processing ( EPP ) costs increased \$3,578,000 or 5% between years. The increase in EPP costs includes a provision for charge-back losses of \$579,000 and \$1,832,000 in 2013 and 2012, respectively. The provision for charge-back losses in 2012 included losses of \$1,312,000 related to a group of merchants affiliated with one of its independent sales agents, which were unilaterally approved by a former senior manager of the EPP division and such charge-back losses resulted from violations of credit policy by such senior manager. EPP revenue less EPP costs, or margin decreased from 15.6% in 2012 to 15.5% in 2013. Margin was favorably impacted by the reduction in provisions for chargebacks between years by 1.5%. However, the favorable impact on margin of the aforementioned factors were slightly more than offset by lower average pricing between years due to both competitive pricing

considerations, particularly for larger volume merchants, and the mix of merchant sales volumes realized between periods. Overall, the increase in margin dollars was \$590,000 between years.

Salaries and benefits decreased by \$506,000 or 13% between years principally as the result of a reduction in staffing levels and a reduction in accrued bonuses for the year. Average FTE s for the twelve month period decreased from 67.5 to 61.2 between years. Professional fees increased by \$135,000 principally due to costs incurred in assessing the loss related to and the actions of the agent and the former senior management of EPP related to the charge-back losses associated with a group of merchants discussed above. Depreciation and amortization decreased \$385,000 between periods as the result of previously acquired customer merchant portfolios becoming fully amortized between periods. Other costs increased \$81,000 or 6% between years. During 2012, office relocation costs of approximately \$50,000 were incurred.

Income before income taxes increased \$1,263,000 to \$8,304,000 in 2013 from \$7,041,000 in 2012. The increase in income before income taxes was principally due to the increase in margin of \$590,000 due to the reasons noted above and the decreases in other costs, principally payroll and related costs and depreciation and amortization cost between years.

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**Table of Contents****2012**

EPP revenue increased \$3,008,000 or 4% between years. Revenue increased due to a combination of growth in processing volumes, selective fee increases, both card association and third-party processor cost increases passed through to merchants (other than debit card transactions) and additions to services provided to our merchants. Processing volumes were favorably impacted by an increase of 3% in the average number of processing merchants under contract between periods. In addition, growth in revenue between periods increased due to an increase of approximately 7% in the average monthly processing volume per merchant, due in part to the addition of several larger volume processing merchants as well as year-over-year growth in processing volumes from existing merchants. The overall increase in revenue between years was adversely impacted by approximately 6% due to the effect of lower pass-through pricing on debit card transactions due to government mandated limits on underlying interchange costs for such transactions, as well as the overall pricing mix of merchant sales volumes realized between periods.

Electronic payment processing costs ( EPP costs ) increased \$2,795,000 or 4% between years. The increase in EPP costs includes a provision for charge-back losses of \$1,271,000 and \$244,000 in 2012 and 2011, respectively, related to a group of merchants affiliated with one of its independent sales agents. Subsequent to December 31, 2012, significant cardholder transaction charge-backs in excess of related cash reserves held at one of the Company's sponsor banks were noted to have occurred for the particular agent's group of merchants. As a result of the exhaustion of such related cash reserves and the likelihood of additional charge-backs continuing in 2013 relating to such merchants, management concluded that based on an analysis of past processing activity of such merchants (who are no longer processing with the Company) that an additional provision for charge-back losses was required as of December 31, 2012. As discussed more fully in Note 26, this loss was the result of violations of credit policy by a senior member of management in the EPP division. The activities and decisions of this manager lead to the \$1,271,000 and \$244,000 charge-back provision in 2012 and 2011, respectively, for chargebacks incurred by a group of merchants unilaterally approved by the senior manager. The overall increase in EPP costs between years was also affected by lower interchange costs on debit card transactions. Beginning in the fourth quarter of 2011, the EPP segment began experiencing lower EPP costs as interchange costs on debit card transactions were reduced for interchange plus priced merchants, as well as others. Processing revenues less electronic payment processing costs ( margin ) decreased from 15.9% in 2011 to 15.6% in 2012. The decrease in margin due to the \$1,271,000 provision for charge-backs was 1.5%. The negative impact on the margin percentage of the additional charge-back loss provision was partially offset by the impact on revenues and EPP costs of the debit card pricing and interchange cost changes also noted above, net of higher residual payments to sales agents which increased \$2,889,000 or 38% between years, as well as changes in the mix of merchant sales volumes processed. Overall, the decrease in margin dollars was \$213,000 between years.

Excluding electronic payment processing costs, other costs decreased \$676,000 or 10% between years. Depreciation and amortization decreased \$676,000 between periods as the result of previously acquired portfolio intangible assets becoming fully amortized between periods. During 2012, office relocation costs of approximately \$50,000 were incurred. Payroll related costs decreased \$4,000 as a decline in average headcount of 2% between years was substantially offset by increased costs related to payroll taxes and employee benefits. Professional fees increased \$53,000 due to several new consulting arrangements entered into during 2012 which were partially offset by lower audit fees between years.

Income before income taxes increased \$884,000 to \$7,041,000 in 2012 from \$6,157,000 in 2011. The increase in income before income taxes was principally due to the decrease in depreciation and amortization cost of \$676,000 between years and was partially offset by the decrease in the margin (operating revenues less electronic payment processing costs) of \$213,000 due to the reasons noted above.



**Table of Contents****Small Business Finance**

| (In thousands):                                    | 2013             | 2012            | 2011            | % Change   |            |
|--|------------------|-----------------|-----------------|------------|------------|
|  |                  |                 |                 | 2013       | 2012       |
| <b>Revenue:</b>                                    |                  |                 |                 |            |            |
| Premium on loan sales                              | \$ 19,456        | \$ 12,367       | \$ 12,468       | 57%        | (1)%       |
| Servicing fee NSBF Portfolio                       | 2,769            | 2,298           | 1,635           | 20%        | 41%        |
| Servicing fee External Portfolio                   | 3,796            | 4,564           | 1,466           | (17)%      | 211%       |
| Interest income                                    | 4,802            | 3,370           | 2,545           | 42%        | 32%        |
| Management fees related party                      |                  | 293             | 585             | (100)%     | (50)%      |
| Other income                                       | 3,289            | 2,516           | 2,326           | 31%        | 8%         |
| <b>Total revenue</b>                               | <b>34,112</b>    | <b>25,408</b>   | <b>21,025</b>   | <b>34%</b> | <b>21%</b> |
| <b>Net change in fair value of:</b>                |                  |                 |                 |            |            |
| SBA loans transferred, subject to premium recourse |                  |                 | (3,366)         | %          | (100)%     |
| SBA loans held for sale                            | 403              | (163)           | 265             | (347)%     | (162)%     |
| SBA loans held for investment                      | (1,629)          | (851)           | (2,392)         | 91%        | (64)%      |
| Warrants   |                  | (111)           |                 | 0%         | (100)%     |
| <b>Total net change in fair value</b>              | <b>(1,226)</b>   | <b>(1,125)</b>  | <b>(5,493)</b>  | <b>9%</b>  | <b>80%</b> |
| <b>Expenses:</b>                                   |                  |                 |                 |            |            |
| Salaries and benefits                              | 7,649            | 6,124           | 4,689           | 25%        | 31%        |
| Interest   | 5,568            | 3,836           | 2,030           | 45%        | 89%        |
| Professional fees                                  | 1,011            | 700             | 474             | 44%        | 48%        |
| Depreciation and amortization                      | 1,241            | 919             | 893             | 35%        | 3%         |
| Provision for loan loss                            | 1,322            | 805             | 751             | 64%        | 7%         |
| Insurance expense-related party                    | 191              | 20              |                 | 855%       | (100)%     |
| Other general and administrative costs             | 5,761            | 3,785           | 2,560           | 52%        | 48%        |
| <b>Total expenses</b>                              | <b>22,743</b>    | <b>16,189</b>   | <b>11,397</b>   | <b>40%</b> | <b>42%</b> |
| <b>Income before income taxes</b>                  | <b>\$ 10,143</b> | <b>\$ 8,094</b> | <b>\$ 4,135</b> | <b>25%</b> | <b>96%</b> |

**Business Overview**

The Small business finance segment is comprised of NSBF which is a non-bank SBA lender that originates, sells and services loans for its own portfolio as well as portfolios of other institutions, and NBC which provides accounts receivable financing and billing services to businesses. Revenue is derived primarily from premium income generated by the sale of the guaranteed portions of SBA loans, interest income on SBA loans held for investment and held for sale, servicing fee income on the guaranteed portions of SBA loans sold, servicing income for loans originated by other lenders for which NSBF is the servicer, and financing and billing services, classified as other income above, provided by NBC. Most SBA loans originated by NSBF charge an interest rate equal to the Prime rate plus an

additional percentage amount; the interest rate resets to the current Prime rate on a monthly or quarterly basis, which will result in changes to the amount of interest accrued for that month and going forward and a re-amortization of a loan's payment amount until maturity.

**Accounting Policy**

On October 1, 2010, the Company elected to utilize the fair value option for SBA 7(a) loans funded on or after that date. For these fair value loans, premium on loan sales equals the cash premium and the value of the servicing asset paid by the

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purchaser in the secondary market, the discount created on the unguaranteed portion from the sale which formerly reduced premium income is now included in the fair value line item, and, by not capitalizing various transaction expenses, the salaries and benefits and loan processing expense lines portray a value closer to the cash cost to operate the lending business. The Company uses a discounted cash flow model to measure the fair value of performing loans held for investment. If a loan measured at fair value is subsequently impaired, then the fair value of the loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral dependent. The significant unobservable inputs used in the fair value measurement of the impaired loans involve management's judgment in the use of market data and third party estimates regarding collateral values. Such estimates are further discounted by 20% - 80% to reflect the cost of liquidating the various assets under collateral. Any subsequent increases or decreases in any of the inputs would result in a corresponding decrease or increase in the reserve for loan loss or fair value of SBA loans, depending on whether the loan was originated prior or subsequent to October 1, 2010. Because the loans bear interest at a variable rate, NSBF does not have to factor in interest rate risk.

Consideration in arriving at the provision for loan loss includes past and current loss experience, current portfolio composition, future estimated cash flows, and the evaluation of real estate and other collateral as well as current economic conditions. For all loans originated on or prior to September 30, 2010, management performed a loan-by-loan review for the estimated uncollectible portion of non-performing loans; subsequent to September 30, 2010, management began recording all loan originations on a fair value basis which requires a valuation reduction of the unguaranteed portion of loans held for investment to a level that takes into consideration future losses. This valuation reduction is reflected in the line item above: Net Change in Fair Value of SBA Loans Held for Investment.

**Small Business Finance Summary**

| (In thousands):  | For the Year ended<br>December 31, |           |         |           |         |           |
|--|------------------------------------|-----------|---------|-----------|---------|-----------|
|  | 2013                               |           | 2012    |           | 2011    |           |
|  | # Loans                            | \$ Amount | # Loans | \$ Amount | # Loans | \$ Amount |
| Guaranteed loans sold/transferred during the period                    | 167                                | 131,733   | 105     | 84,743    | 102     | 73,871    |
| Gross loans originated during the period                               | 174                                | 177,941   | 104     | 107,425   | 102     | 97,129    |
| Guaranteed loans that achieved sale status, originated in prior period |                                    |           |         |           | 47      | 30,783    |
| Premium income recognized (1)(2)                                       |                                    | \$ 19,456 |         | \$ 12,367 |         | \$ 12,468 |
| Average sale price as a percent of principal balance (2)               |                                    | 112.32%   |         | 112.22%   |         | 110.56%   |

- (1) Of the total premium recognized for the year ended December 31, 2011, \$3,196,000 was from previously originated loans that achieved sale status as a result of the warranty period expiring.
- (2) The premium income recognized and average sales price reflect that premiums greater than 110.00% must be split 50/50 with the SBA.

For the year ended December 31, 2013, the Company recognized \$19,456,000 of premium income from 167 guaranteed loans sold aggregating \$131,733,000. During 2012, the Company recognized \$12,367,000 of premium income from 105 guaranteed loans sold totaling \$84,743,000. The increase in premium income for the year ended



December 31, 2013 is the result of an increased number of loans sold as compared with the prior period. Sale prices on guaranteed loan sales averaged 112.32% for the twelve months ended December 31, 2013 compared with 112.22% for the twelve months ended December 31, 2012.

**Table of Contents****Servicing Portfolios and related Servicing fee income**

| (In thousands):                                  | Year ended<br>December 31, |            |            | % Change |      |
|--|----------------------------|------------|------------|----------|------|
|  | 2013                       | 2012       | 2011       | 2013     | 2012 |
| Total NSBF originated servicing portfolio (1)    | \$ 488,800                 | \$ 351,736 | \$ 286,113 | 39%      | 23%  |
| Third party servicing portfolio                  | 561,368                    | 176,988    | 136,971    | 217%     | 29%  |
| Aggregate servicing portfolio                    | \$ 1,050,168               | \$ 528,724 | \$ 423,084 | 99%      | 25%  |
| Total servicing income earned NSBF portfolio     | \$ 2,769                   | \$ 2,298   | \$ 1,635   | 20%      | 41%  |
| Total servicing income earned external portfolio | \$ 3,796                   | \$ 4,564   | \$ 1,466   | (17)%    | 211% |
| Total servicing income earned                    | \$ 6,565                   | \$ 6,862   | \$ 3,101   | (4)%     | 121% |

(1) Of this amount, the total average NSBF originated portfolio earning servicing income was \$314,486,000, \$238,590,000, and \$192,126,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

We are the contractor managing and servicing portfolios of SBA 7(a), USDA and other loans acquired by the FDIC from failed financial institutions, and we assist the FDIC in the packaging of these loans for sale. During November 2012 and April 2013, the FDIC was successful in selling a significant group of loans with our assistance, which resulted in a reduction in current servicing income from the FDIC, offset by the addition of servicing income from other third party financial institutions. Our existing servicing facilities and personnel perform these activities supplemented by contract workers as needed. The size of the portfolio we will service for the FDIC, and thus the revenue earned, varies and depends on the level of bank failures and the needs of the FDIC in managing portfolios acquired from those banks as well as the success of being able to sell such portfolios. We continued to add third party loan servicing contracts in 2013, for both the FDIC and other third parties, which we expect will reverse the decline.

The \$297,000 decline in total servicing income was attributable primarily to the decrease in FDIC servicing income of \$1,278,000 as a result of the sale of a portion of that portfolio, which was offset by an increase in other third party loan servicing of \$511,000. With the addition in November 2013 of the Community South Bank portfolio, which we service for the FDIC, as well as the addition of other third party loan servicing contracts in 2013, the average third party servicing portfolio increased from \$195,670,000 for the twelve month period ended December 31, 2012 to \$232,410,000 for the same twelve month period in 2013. Servicing fees received on the NSBF portfolio increased by \$471,000 period over period and was attributable to the expansion of the NSBF originated portfolio in which we earn servicing income. The portfolio increased from an average of \$238,590,000 for the twelve month period ending December 31, 2012 to an average of \$314,486,000 for the same twelve month period in 2013. This increase was the direct result of increased loan originations in 2013.

Interest income increased by \$1,432,000 for the year ended December 31, 2013 as compared to the same period in 2012 as a result of the average outstanding performing portfolio of SBA loans held for investment increasing to \$72,337,000 from \$48,512,000 for the years ended December 31, 2013 and 2012, respectively.

Other income increased by \$772,000 for the year ended December 31, 2013 as compared to the same period in 2012. The increase is primarily attributable to NSBF which increased \$616,000 period over period and included an increase of \$333,000 in consulting fee income from the FDIC and an increase in packaging and other servicing fee income of

\$188,000. The remaining increase was attributable to loan recovery and various loan-related fee income. Additionally, other income at NBC increased by \$160,000 due to an increase in net investments on accounts receivable, which increased from an average of \$7,707,000 in 2012 to an average of \$8,688,000 in 2013, as well as an increase in the merchant cash advance program on which we earn commission revenue.

The change in fair value associated with SBA loans held for sale of \$566,000 is related to the amount of unsold guaranteed loans during a period, the timing of when those loans sell and the change in premium being received on those loans. The amount of unsold guaranteed loans increased by \$3,325,000 at December 31, 2013 compared with 2012, while there was a decrease of \$1,032,000 in the amount of unsold guaranteed loans at December 31, 2012 compared to 2011.

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The decrease in the change in fair value on SBA loans held for investment of \$778,000 is the result of the increased amount of unguaranteed loans originated year over year, as well as a decrease in the valuation adjustment applied to our loans held for investment portfolio. During 2013, we adopted a discounted cash flow methodology resulting in a decrease in the valuation adjustment applied of 7.5% of total principal as of December 31, 2012, to 6.01% of total principal for the year ended December 31, 2013. Loans originated, held for investment aggregated \$42,773,000 compared to \$24,076,000 for the years ended December 31, 2013 and 2012, respectively.

Salaries and benefits increased by \$1,525,000 primarily due to the addition of staff in all departments. Combined headcount increased by 24% from an average of 62 employees for the year ended December 31, 2012, to an average of 77 for the year ended December 31, 2013.

Interest expense increased by \$1,732,000 for the year ended December 31, 2013 compared with the same period in 2012, due primarily to \$663,000 of interest expense associated with the Summit financing transaction which closed in April 2012 reflecting only 8 months of expense for the period ending December 31, 2012 vs. twelve months expense for 2013. Interest expense for Summit includes interest, payment in kind interest, discount on the valuation of the warrant and amortization of deferred financing costs. Additionally, NSBF experienced an increase in interest expense of \$638,000 in connection with the closing of the 2013 securitization transactions in March and December 2013, and an additional \$334,000 increase related to the Capital One line of credit which increased from an average outstanding balance of \$10,674,000 for the year ended December 31, 2012 to \$16,587,000 for the same period in 2013. NBC experienced an increase in interest expense of \$131,000 under the Sterling credit facility due to increased borrowings under the Sterling credit facility as a result of an increasing portfolio.

Professional fees for the year ended December 31, 2013 increased by \$311,000 when compared with the year ended December 31, 2012, primarily due to the addition of temporary staffing costs of \$166,000, increased accounting fees of \$171,000 and increased trustee fees of \$48,000. These increases were offset by a reduction in legal expense period over period of approximately \$87,000 and a reduction in employee search fees of \$16,000.

**Loan loss reserves and Change in fair value, loans held for investment**

| (In thousands):                                     | Year ended<br>December 31: |           |           | % Change |       |
|---|----------------------------|-----------|-----------|----------|-------|
|   | 2013                       | 2012      | 2011      | 2013     | 2012  |
| Total reserves and discount, beginning of year      | \$ 6,092                   | \$ 5,566  | \$ 3,844  | 9%       | 45%   |
| Provision for loan losses                           | 1,322                      | 805       | 751       | 64%      | 7%    |
| Net change in fair value, loans held for investment | 1,629                      | 851       | 2,393     | 91%      | (64)% |
| Charge offs (net of recoveries)                     | (2,221)                    | (1,130)   | (1,422)   | 97%      | (21)% |
| Total reserves, end of year                         | \$ 6,822                   | \$ 6,092  | \$ 5,566  | 12%      | 9%    |
| Gross portfolio balance, end of year                | \$ 97,235                  | \$ 64,609 | \$ 47,030 | 50%      | 37%   |
| Total impaired nonaccrual loans, end of year        | \$ 7,653                   | \$ 6,757  | \$ 6,766  | 13%      | %     |

The combined provision for loan losses and net change in fair value increased from \$1,656,000 for the year ended December 31, 2012 to \$2,951,000 for year ended December 31, 2013, a net increase of \$1,295,000 period over period. The allowance for loan loss together with the cumulative fair value adjustments to SBA loans held for investment increased from \$6,092,000 or 9.4% of the gross portfolio balance of \$64,609,000 at December 31, 2012 to \$6,822,000

or 7.0% of the gross portfolio balance of \$97,235,000 at December 31, 2013. Of this, \$2,315,000 or 34.3% and \$1,757,000 or 23.0% of the allowance for loan losses and fair value discount was allocated as specific reserve against such impaired loans, for the 2012 and 2013 periods, respectively. The year over year reduction in non-performing loans as a percentage of the gross performing portfolio balance results from an improvement in the overall economic climate. The year over year reduction in the specific reserve reflects both the relatively high level of overall collateralization on the non-performing portfolio as well as the increase in the portion of that portfolio making periodic payments pending return to performing status, reducing the need for a specific reserve at this time.

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In determining the net change in fair value of loans held for investment for the year ended December 31, 2013, the Company used a discounted cash flow model which incorporated a series of expected future cash flows for the performing SBA 7(a) loan portfolio, and discounts those cash flows at a market clearing yield of 5.38%. The key assumptions used in the model are considered unobservable inputs and include anticipated prepayment speeds, cumulative default rates, the cost of loan servicing, and Prime rate expectations. The Company used an assumed prepayment speed of 10% based on current market conditions and historical experience for the loan portfolio, against a prepayment curve developed from NSBF historical experience to calculate expected loan prepayments in a given year. Defaults are defined as any loan placed on non-accrual status as of December 31, 2013. The cumulative default rate, defined as the percent of loan balance that will enter final liquidation in a given year, was estimated to be 25%, and was derived from NSBF historical experience. The mix of NSBF's loan portfolio continues to shift from start-up businesses, to predominately originating to existing businesses. Our historical default and loss rates demonstrate that this particular segment (i.e. Existing Business) of our SBA loan portfolio continues to experience the lowest rate of defaults and ultimate losses over our nine year history of originating loans. When computing the cumulative default rate to be applied to the performing portfolio loan balances, the Company excluded the last three years of originations as those loans have not seasoned yet. The discounted cash flow analysis resulted in a price equivalent of 93.99% of the par amount on our loans held for investment.

Other general and administrative costs increased by \$1,976,000 due primarily to the increase in loan origination, processing and servicing costs in the amount of \$607,000 as a result of the increase in loans originated and portfolios serviced, an additional \$360,000 in marketing costs relating to the Company's television ad campaign, an additional \$324,000 in rent, utilities and office expense due to the addition of office space and headcount and an increase of \$122,000 in loan recovery costs, which includes expenses and losses associated with the sale of foreclosed properties and collateral preservation costs, as compared with the same period in 2012. \$472,000 was attributable to additional reserves recorded at NBC to account for two customers. The rest of the increase was attributable to other miscellaneous expenses.

The increase of loan originations and interest, generated by the addition to and the reduction in non-performing loans in the SBF portfolio, were sufficient to offset additional staffing costs, interest and other general and administrative expenses. The resulting pretax income of \$10,143,000 was a 25% improvement over pretax income of \$8,094,000 for the year ended December 31, 2012.

**2012**

Revenue is derived primarily from premium income generated by the sale of the guaranteed and unguaranteed portions of SBA loans. Additionally, the Company derives revenue from interest income on SBA loans held for investment and held for sale, servicing fee income on the guaranteed portions of SBA loans previously sold, servicing income for loans originated by other lenders for which NSBF is the servicer, and financing and billing services, classified as other income above, provided by NBC. Most SBA loans originated by NSBF charge an interest rate equal to the Prime rate plus an additional percentage amount; the interest rate resets to the current Prime rate on a monthly or quarterly basis, which will result in changes to the amount of interest accrued for that month and going forward and a re-amortization of a loan's payment amount until maturity.

The implementation of Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) Topic 860 Transfers and Servicing, which became effective January 1, 2010, delayed the recognition of premium income for sales of the guaranteed portions of SBA loans. In 2010 and prior, SBA Form 086 required, as part of the transferor's representations and warranties, that the transferor repay any premium received from the transferee if either the SBA 7(a) loan borrower prepays the loan within 90 days of the transfer settlement date or fails to make one of its first three loan payments after the settlement date in a timely fashion and then proceeds to default within 275 days of

the settlement date. Under ASC Topic 860, such recourse precludes sale treatment of the transferred guaranteed portions during this warranty period; rather NSBF was required to account for this as a financing arrangement with the transferee. Until the warranty period expired such transferred loans were classified as SBA loans transferred, subject to premium recourse with a matching liability Liability on SBA loans transferred, subject to premium recourse. In January 2011, the SBA issued a notice stating that Form 1086 would be revised to remove all reference to a warranty period for loans sold in the secondary market. This change became effective February 7, 2011 and allowed the Company to recognize premium income concurrent with the date of transfer, as was done prior to January 1, 2010.

In 2010, the Company elected the fair value option for valuing Liability on SBA loans transferred, subject to premium recourse, and also elected to utilize the fair value option for SBA 7(a) loans funded on or after that date. As a result, the Company recorded changes in the fair value for the guaranteed portions that were not transferred at period end ( SBA loans held for sale ) and for loans transferred in the secondary market that did not achieve sale status under ASC Topic 860 ( SBA loans transferred, subject to recourse ). At the expiration of the warranty period, the sale of the guaranteed portions of these loans as well as the corresponding gain was recognized into premium income, and the asset and liability eliminated.

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On October 1, 2010, the Company elected to utilize the fair value option for SBA 7(a) loans funded on or after that date. For loans funded on or after October 1, 2010, the income statement separates the revenue and expense components mixed into premium on loan sales: premium on loan sales equals the cash premium and servicing asset paid by purchaser in the secondary market, the discount created on the unguaranteed portion is included in the fair value line item, and by not capitalizing various transaction expenses the salary and benefit and loan processing costs expense lines portray a value closer to the cash cost to operate the lending business.

For the year ended December 31, 2012, the Company recognized \$12,367,000 of premium income from 105 loans sold aggregating \$84,743,000. During 2011, the Company recognized \$9,272,000 of premium income from 102 loans sold totaling \$73,871,000 not subject to the premium warranty, and 47 loans aggregating \$30,783,000 previously subject to the premium warranty that achieved sale status during 2011. The decrease in premium income for the year ended December 31, 2012 as compared with the prior period was due entirely to the reversal of the fair value adjustment of \$3,196,000 associated with SBA loans transferred, subject to premium recourse, which increased premium income for the same amount for the year ended December 31, 2011. Sale prices on guaranteed loan sales averaged 112.22% for the twelve months ended December 31, 2012 compared with 110.56% for the twelve months ended December 31, 2011.

The \$3,763,000 improvement in total servicing income was attributable primarily to third party loan servicing, which increased by \$3,100,000 for the year ended December 31, 2012 compared to the year ended December 31, 2011. The twelve month average third party servicing portfolio increased from \$96,398,000 to \$200,737,000 for the 2011 and 2012 annual periods, respectively. In addition, servicing fees received from the SBA on repurchased loans increased by \$154,000 and the remaining increase of \$512,000 was attributable to the expansion of the NSBF portfolio, in which we earn servicing income, which increased from an average of \$192,126,000 for the twelve month period ended December 31, 2011 to an average of \$238,590,000 for the same twelve month period in 2012. This increase was the direct result of increased loan originations throughout 2011 and 2012.

Interest income increased by \$825,000 for the year ended December 31, 2012 as compared to 2011. This increase was attributable to an additional \$1,169,000 of interest income as a result of the average outstanding performing portfolio of SBA loans held for investment increasing to \$48,512,000 from \$29,649,000 for the years ended December 31, 2012 and 2011, respectively. Results for 2011 included \$344,000 in interest earned from SBA loans transferred, subject to recourse; all transferred loans achieved sales status as of December 31, 2011.

Other income increased by \$188,000 primarily due to a \$277,000 increase in revenues at NBC. Fees earned on receivable advances increased by \$118,000 which was attributable to an increase in the average of financed receivables from \$4,937,000 in 2011, to \$6,025,000 in 2012. Annual fees, due diligence fees and under minimum fees increased by an aggregate of \$237,000 year over year, while commissions, late fees and billing service revenue, along with other miscellaneous fees decreased by an aggregate of \$78,000 year over year. Increases in other income attributable to NBC was offset by an \$86,000 reduction in other income at NSBF attributable to recognizing fewer expense recoveries and packaging fees.

The increase in the net change in fair value associated with SBA loans transferred, subject to premium recourse, is the direct result of all previously transferred loans having achieved sale status during 2011 as well as the SBA removing the warranty provision allowing the Company to recognize premium income on the date of sale. During the year ended December 31, 2011, as a result of the expiration of the premium warranty, all previously transferred loans were recognized as sales, thereby reducing the corresponding fair value adjustment by \$3,366,000. The change in fair value associated with SBA loans held for sale is related to the total amount of loans converted from partially funded to fully funded status during a given period. The decrease in the change in fair value on SBA loans held for investment is a result of reducing the upfront discount recognized on unguaranteed loans, from 11% to 9.5% during the first quarter of



2012 and further reduced to 7.5% at December 31, 2012. This reduction was determined based upon internal quantitative data on our portfolio with respect to historical default rates and future expected losses as well as the investor price paid for the senior interest in our unguaranteed loans with respect to our two securitized transactions, adjusted for the estimated servicing and interest income retained by the trust over an estimated repayment term of three years and further adjusted to reflect the estimated default rate on the senior notes based on the default rate on our loan portfolio, assuming a worst case scenario of no recoveries. During the year ended December 31, 2012, loans originated and held for investment aggregated \$24,076,000 resulting in a corresponding fair value loss of \$851,000, representing an improvement of \$1,542,000 over 2011. In connection with the Summit financing transaction which closed in April 2012, the Company recorded a fair value loss of \$111,000 for the twelve months ended December 31, 2012 to reflect the fair value of warrants issued as part of the transaction. The warrants have since been replaced to remove the anti-dilutive provision which reflected management's and Summit's original intent regarding the nature of the warrants, and as such will no longer be marked to market.

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Salaries and benefits increased by \$1,435,000 primarily due to increases in salaries, bonus accrual, as well as the addition of staff in the originating, servicing and liquidation departments for both internal and external loan portfolios. Combined headcount increased by 22% from an average of 51 employees for the year ended December 31, 2011, to an average of 62 for the year ended December 31, 2012.

Interest expense increased by \$1,806,000 for the year ended December 31, 2012 compared with the same period in 2011, due primarily to \$1,422,000 of interest expense associated with the Summit financing transaction which closed in April 2012. While the Summit financing was transacted with the parent company, these funds were provided to and utilized by NSBF; as a result, the corresponding expense has been recorded in the lending segment. The \$1,422,000 includes interest, payment-in-kind interest, discount on the valuation of the warrant and amortization of deferred financing costs. Additionally, NSBF experienced an increase in interest expense of \$624,000 in connection with the closing of the second securitization transaction in December 2011 and an additional \$56,000 increase related to the Capital One line of credit which increased from an average outstanding balance of \$7,654,000 for the year ended December 31, 2011 to \$10,674,000 for the same period in 2012. NBC experienced an increase in interest expense of \$55,000 under the Sterling credit facility due to increased borrowings under the Sterling credit facility as a result of an increasing portfolio. Other interest expense paid to third party increased by \$20,000. These increases were offset by a reduction of \$344,000 attributable to the liability for SBA loans transferred, subject to premium recourse, which was reduced to zero in 2011 and a decrease of interest expense at NBC by \$27,000 due to the write off of the remaining deferred financing cost under the Wells Fargo line in 2011.

Professional fees for the year ended December 31, 2012 increased by \$226,000 when compared with the year ended December 31, 2011 primarily due to an increase in consulting fees associated with third party servicing, due diligence fees, search fees and fees associated with the trustee for the loan portfolio securitization.

The combined provision for loan loss and net change in fair value decreased from \$3,144,000 for the year ended December 31, 2011 to \$1,656,000 for year ended December 31, 2012, a net decrease of \$1,488,000 period over period. The allowance for loan loss together with the cumulative adjustment related to SBA loans held for investment increased from \$5,566,000 or 11.8% of the gross portfolio balance of \$47,030,000 at December 31, 2011 to \$6,092,000 or 9.4% of the gross portfolio balance of \$64,609,000 at December 31, 2012. This decrease in reserve percentage is a result of the decrease in the upfront discount from 11% to 7.5% as well as the positive performance of the portfolio. Total impaired non-accrual loans decreased from \$6,766,000 or 14.4% of the total portfolio at December 31, 2011 to \$6,757,000 or 10.5% at December 31, 2012 with \$2,417,000 or 35.7% and \$2,189,000 or 32.4% of the allowance for loan losses being allocated against such impaired non-accrual loans, respectively. The year over year reduction in non-performing loan percentage results from an improvement in the overall economic climate, as well as a shift in the underwriting and origination of loans from start-up type businesses to existing businesses and business acquisitions. The year over year reduction in the specific reserve reflects both the relatively high level of overall collateralization on the non-performing portfolio as well as the increase in the portion of that portfolio making periodic payments pending return to performing status, reducing the need for a specific reserve at this time.

Other general and administrative costs increased by \$1,225,000 due primarily to the increase in loan originating, processing and servicing costs in the amount of \$397,000 as a result of the increase in loans originated and portfolios serviced and an increase of \$490,000 in loan recovery costs, which includes expenses and losses associated with the sale of foreclosed properties and collateral preservation costs, as compared with the same period in 2011. Additionally, marketing costs increased by \$204,000 primarily in conjunction with the launch of NEWTEK® *The Small Business Authority*, a new marketing campaign initiated by the Company in May 2012.

The increase of loan originations and the size of the portfolio, combined with improvements in sale pricing as well as servicing and interest, generated by the addition to and enhanced performance of the portfolio, and an increase in third

party servicing, were sufficient to offset additional salaries, servicing and origination expenses. The resulting pretax income of \$8,094,000 for the year ended December 31, 2012 was a 96% improvement over pretax income of \$4,135,000 for the year ended December 31, 2011.

**Table of Contents****Managed Technology Solutions**

| (In thousands):                        | 2013      | 2012      | 2011      | % Change |        |
|--|-----------|-----------|-----------|----------|--------|
|  |           |           |           | 2013     | 2012   |
| Revenue:                               |           |           |           |          |        |
| Web hosting and design                 | \$ 17,576 | \$ 18,211 | \$ 19,183 | (3%)     | (5%)   |
| Interest income                        |           |           | 1         | %        | (100%) |
| Total revenue                          | 17,576    | 18,211    | 19,184    | (3%)     | (5%)   |
| Expenses:                              |           |           |           |          |        |
| Salaries and benefits                  | 5,103     | 5,216     | 4,755     | (2%)     | 10%    |
| Interest                               | 94        | 80        | 104       | 18%      | (23%)  |
| Professional fees                      | 507       | 465       | 692       | 9%       | (33%)  |
| Depreciation and amortization          | 1,316     | 1,214     | 1,387     | 8%       | (12%)  |
| Insurance expense related party        | 14        | 17        | 4         | (18)%    | 325%   |
| Other general and administrative costs | 6,978     | 6,965     | 7,405     | %        | (6%)   |
| Total expenses                         | 14,012    | 13,957    | 14,347    | %        | (3%)   |
| Income before income taxes             | \$ 3,564  | \$ 4,254  | \$ 4,837  | (16%)    | (12%)  |

**2013**

Revenue is derived primarily from recurring fees from hosting websites, primarily from monthly contracts for shared hosting, dedicated servers and cloud instances (the plans). In addition, less than 4% of revenues are derived from contracted services to design web sites. Revenue between years decreased 3% to \$17,576,000 in 2013 and included an \$856,000 reduction in web hosting revenue, which was partially offset by a \$221,000 increase in web design revenue. While the average number of web hosting plans decreased by 11% to 44,988 in 2013 from 50,720 in 2012, the average monthly revenue per plan increased by 9% to \$32.56 in 2013 from \$29.92 in 2012. The increase in the average revenue per plan reflects a growth in cloud instances, and higher cost plans overall which include additional options and services. The average number of cloud instances increased by 6% to an average of 669 in 2013 from 634 during the year ago period. The decrease in the average total plans occurred in the dedicated and shared segments.

The average monthly number of dedicated server plans in 2013, which generate a higher monthly fee versus shared hosting plans, decreased by 19% in 2013 to an average of 1,206 from 1,485 in 2012. The average monthly number of shared hosting plans in 2013 decreased by 5,488, or 11%, to an average of 43,113 from 48,601 in 2012. Competition from other web hosting providers as well as alternative website services continues to have a negative effect on web hosting plan count and revenue growth.

It continues to be management's intent to increase revenues and margin per plan through higher cost service offerings to customers, although this may result in a lower number of plans in place overall. In addition, management has begun to lessen its dependency on the Microsoft web platform by broadening its platform capabilities to include more open source web applications which have become increasingly more attractive to web developers and resellers. Overall this continues the trend away from shared hosting sites based on Microsoft software to other more competitive offerings.

Total expenses of \$14,012,000 in 2013 increased from \$13,957,000 in 2012. Salaries and benefits decreased \$113,000 or 2% between years to \$5,103,000. Depreciation and amortization cost increased \$102,000 between years to \$1,316,000 due to increased capital expenditures in the latter part of 2012 (including a capital lease obligation of \$632,000 for a new company-wide telephone system) and the timing of 2013 planned capital expenditures. The increase of \$42,000 in professional fees was principally due to an increase in web design costs incurred, which corresponds to the increase in web design revenues between periods. Other general and administrative costs increased \$13,000 between years as a result of increases in hardware maintenance and support costs of \$176,000, principally due to the restructuring of previous contracts in those areas, as well as an increase in bad debt expense by \$114,000. These increases were offset by decreases in rent and utility costs of \$176,000 in 2012, due to additional rent incurred in 2012 of \$30,000 for a corporate apartment and \$32,000 higher base rent from the former location as well as higher utility costs incurred in 2012. In addition, there was a decrease in telephone costs of \$84,000 due to a new corporate-wide phone system implemented in 2013.

Income before income taxes decreased 16% or \$690,000 to \$3,564,000 in 2013 from \$4,254,000 in 2012. The decrease in profitability is principally due to a decline in web hosting revenue between years as increases in revenue per site have not offset an overall decline in revenue due to site attrition.

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**Table of Contents****2012**

Revenue is derived primarily from recurring fees from hosting websites, including monthly contracts for shared hosting, dedicated servers and cloud instances (the plans). In addition, less than 2% of revenues are derived from contracted services to design web sites. Revenue between years decreased \$973,000, or 5%, to \$18,211,000 in 2012. The decrease in revenues included a decrease in web hosting revenue of \$750,000 and web design revenues of \$223,000 between years. The decrease in web hosting revenue is the result of a decrease in the average monthly number of total plans by 5,631 or 10% between years to 50,720 plans in 2012 from 56,351 plans in 2011. Partially offsetting the decrease in web hosting revenue resulting from the decline in plans was an increase in the average monthly revenue per plan of 5% to \$29.92 in 2012 from \$28.37 in 2011. The increase in the average revenue per plan reflects a growth in cloud instances and customers purchasing higher cost plans including additional options and services. The average number of cloud instances increased by 267 to an average of 634 from 367 in 2011 reflecting the Company's introduction of a customer scalable cloud offering in 2011. The decrease in the average total plans occurred in the shared and dedicated segments. The average monthly number of dedicated server plans in 2012, which generate a higher monthly fee versus shared hosting plans, decreased by 355 between years, or 19%, to an average of 1,485 from an average of 1,840 in 2011. The average monthly number of shared hosting plans in 2012 decreased by 5,542, or 10%, to an average of 48,601 from 54,143 in 2011. Competition from other web hosting providers as well as alternative website services continues to have a negative effect on web hosting plan count and revenue growth.

It continues to be management's intent to increase revenues and margin per plan through higher service offerings to customers, although this may result in a lower number of plans in place overall. In addition, management has begun to lessen its dependency on the Microsoft web platform by broadening its platform capabilities to include more open source web applications which have become increasingly more attractive to web developers and resellers.

Total expenses of \$13,957,000 in 2012 declined 3% from \$14,347,000 in 2011. Salaries and benefits increased \$461,000 or 10% between years to \$5,216,000. The growth in salaries and benefits is principally due to adding additional staffing in customer service areas and executive management as well as wage rate increases between periods. Depreciation and amortization cost decreased \$173,000 between years to \$1,214,000 due to reduced capital expenditures in recent years as a result of lower replacement costs for new equipment overall, more efficient use of existing equipment within the data center for shared and dedicated plans and the utilization of cloud architecture to more efficiently provide services to customers. The decrease of \$227,000 in professional fees was primarily due to a decrease in web design development costs as a result of a decrease in web design revenues between years. In addition, professional fees also decreased due to the timing of the incurrence of security assurance services between years. Other general and administrative costs decreased \$440,000 or 6% between years. Included in other expenses in 2011 was an expense of \$190,000 resulting from the resolution of a licensing dispute. Excluding the one-time settlement in 2011, other expense decreased \$250,000 between years. Increases in domain costs of \$50,000 and hardware maintenance and support of \$121,000, principally due to the restructuring of previous contracts in those areas, were more than offset by a reduction in bad debt expense of \$184,000 due to lower revenues in 2012 and improved collection efforts between years. In addition, lease expense and utility costs decreased by \$237,000 between years due a new lease resulting from moving to a new management office location in 2012 and lower data center utility costs.

Income before income taxes decreased 12% or \$583,000 to \$4,254,000 in 2012 from \$4,837,000 in 2011. The decrease in profitability is principally due to a decline in web hosting revenue between years as increases in revenue per site have not offset an overall decline in revenue due to site attrition and, additionally, such decline in revenue has only been partially offset by cost reductions (including the impact of a \$190,000 licensing settlement cost in 2011).



**Table of Contents****All Other**

| (In thousands):                        | 2013              | 2012              | 2011            | % Change     |              |
|--|-------------------|-------------------|-----------------|--------------|--------------|
|  |                   |                   |                 | 2013         | 2012         |
| Revenue:                               |                   |                   |                 |              |              |
| Insurance commissions                  | \$ 1,737          | \$ 1,204          | \$ 1,071        | 44%          | 12%          |
| Insurance commissions related party    | 235               | 153               | 127             | 54%          | 20%          |
| Other income                           | 516               | 419               | 627             | 23%          | (33)%        |
| Other income related party             | 80                | 82                |                 | (2)%         | 100%         |
| Interest income                        |                   | 2                 | 10              | (100)%       | (80)%        |
| <b>Total revenue</b>                   | <b>2,568</b>      | <b>1,860</b>      | <b>1,835</b>    | <b>38%</b>   | <b>1%</b>    |
| Expenses:                              |                   |                   |                 |              |              |
| Salaries and benefits                  | 2,511             | 2,040             | 1,881           | 23%          | 8%           |
| Professional fees                      | 621               | 253               | 181             | 145%         | 40%          |
| Depreciation and amortization          | 203               | 36                | 80              | 464%         | (55)%        |
| Insurance expense related party        | 9                 | 9                 |                 | %            | 100%         |
| Other general and administrative costs | 830               | 560               | 427             | 48%          | 31%          |
| <b>Total expenses</b>                  | <b>4,174</b>      | <b>2,898</b>      | <b>2,569</b>    | <b>44%</b>   | <b>13%</b>   |
| <b>Loss before income taxes</b>        | <b>\$ (1,606)</b> | <b>\$ (1,038)</b> | <b>\$ (734)</b> | <b>(55)%</b> | <b>(41)%</b> |

The All other segment includes revenues and expenses primarily from Newtek Insurance Agency, LLC ( NIA ), Newtek Payroll Services ( PAY ) and qualified businesses that received investments made through the Company's Capcos which cannot be aggregated with other operating segments.

**2013**

Revenue increased by \$708,000, attributable primarily to a \$615,000 improvement in combined insurance commission revenue for the year ended December 31, 2013 compared with the year ago period. Insurance commissions increased as a result of the acquisition of a commercial health insurance book of business, while the increase in related party commissions was due to premium increases on the Newtek insurance policies, as well as the shift to in-house management of the Newtek health policies, formerly managed by an outside broker. The \$97,000 increase over 2012 in other income is the result of the growth in the number of PAY clients which increased to 465 at December 31, 2013 from 262 at December 31, 2012.

Salaries and benefits increased by \$471,000 to \$2,511,000 for the year ended December 31, 2013, as compared to \$2,040,000 in the year ago period as a result of the addition of staff at NIA and PAY, and Advanced Cyber Security Systems ( ACS ). The \$368,000 increase in professional fees is mainly due to broker commissions for insurance sales related to the new health book of business at NIA, as well as an increase in legal expenses at PAY in connection with a matter related to a former ACH provider. The increase in other general and administrative costs was related to additional software licensing expense, which increased by \$186,000 at ACS and \$83,000 at NIA to manage the expanded health book of business.



**2012**

Total revenue increased by 1%, or \$25,000 for the twelve months ended December 31, 2012 compared to the year ago period. Total insurance commissions increased by \$159,000 during 2012 compared with 2011, due primarily to an increase in force placed insurance commissions, as well as an increase in related party commission revenue. The \$126,000 decrease in combined other income in 2012 was due to a \$337,000 gain on an investment held by an equity method investee which was sold in 2011. Partially offsetting this decrease was a \$225,000 improvement in revenue by PAY, which increased the number of clients from 93 in 2011 to 262 in 2012. All related party revenue, which represents insurance commissions earned on policies sold by NIA and fees charged by PAY to Newtek and subsidiaries, are eliminated upon consolidation.

Salaries and benefits increased by \$159,000, and other general and administrative costs increased by \$133,000 during 2012 both of which were due primarily to activities related to PAY. Average headcount increased by 30% between years, and the increase in other expense related to servicing the new clients added at PAY. The \$72,000 increase in professional fees was attributable to broker commissions for insurance policies sold by NIA during 2012.

**Table of Contents****Corporate activities**

| (In thousands):                            | 2013         | 2012         | 2011          | % Change   |              |
|--|--------------|--------------|---------------|------------|--------------|
|  |              |              |               | 2013       | 2012         |
| Revenue:                                   |              |              |               |            |              |
| Management fees related party              | \$ 896       | \$ 776       | \$ 1,067      | 15%        | (27)%        |
| Interest income                            | 2            | 4            | 21            | (50)%      | (81)%        |
| Other income                               | 2            | 5            | 4             | (60)%      | 25%          |
| <b>Total revenue</b>                       | <b>900</b>   | <b>785</b>   | <b>1,092</b>  | <b>15%</b> | <b>(28)%</b> |
| Expenses:                                  |              |              |               |            |              |
| Salaries and benefits                      | 5,779        | 4,943        | 5,695         | 17%        | (13)%        |
| Professional fees                          | 1,309        | 969          | 1,193         | 35%        | (19)%        |
| Depreciation and amortization              | 161          | 118          | 163           | 36%        | (28)%        |
| Lease restructuring charges (amortization) | (291)        | (291)        | 990           |            | (100)%       |
| Insurance expense related party            | 131          | 57           | 72            | 130%       | (21)%        |
| Other general and administrative costs     | 1,813        | 2,500        | 3,149         | (27)%      | (30)%        |
| <b>Total expenses</b>                      | <b>8,902</b> | <b>8,296</b> | <b>11,262</b> | <b>7%</b>  | <b>(26)%</b> |
| Loss before income taxes                   | \$ (8,002)   | \$ (7,511)   | \$ (10,170)   | (7)%       | 26%          |

The Corporate activities segment implements business strategy, directs marketing, provides technology oversight and guidance, coordinates and integrates activities of the other segments, contracts with alliance partners, acquires customer opportunities, and owns our proprietary NewTracker referral system and all other intellectual property rights. This segment includes revenue and expenses not allocated to other segments, including interest income, Capco management fee income, and corporate operating expenses. These operating expenses consist primarily of internal and external public accounting expenses, internal and external corporate legal expenses, corporate officer salaries, sales and marketing expense and rent for the principal executive offices.

**2013**

Revenue is derived primarily from management fees earned from the Capcos. These related party management fees increased by \$120,000 to \$896,000 for the year ended December 31, 2013 from \$776,000 from the year ago period. Related party management fees, which are eliminated upon consolidation, are expected to decline in the future as the Capcos mature and utilize their cash. If a Capco does not have current or projected cash sufficient to pay management fees, then such fees are not accrued.

Total expenses increased \$606,000, or 7%, for the year ended December 31, 2013 compared with 2012. Salaries and benefits increased a total of \$836,000 due to the addition of new staff primarily in the sales, executive and the human resources departments. Professional fees increased by \$340,000 year over year due to additional audit and legal fees incurred in connection with the restatement of the 2011 and 2012 financial statements, as well as additional costs associated with the Company exploring various financing transactions. The \$43,000 increase in depreciation and amortization was related to the capitalization of website development costs, and insurance expense related party rose by \$74,000 as a result of increased premiums for the renewal of our corporate policies. These increases were partially

offset by a decrease in other general and administrative costs that included a \$244,000 reversal of an accrual for a contract dispute that was settled during the year, as well as reductions of \$225,000 and \$168,000 in IT expense and rent, respectively, as well as a decrease of \$123,000 in other office related expenses.

Loss before income taxes increased \$491,000 for the twelve months ended December 31, 2013 compared to the prior year, primarily due to the increases in salaries and benefits, professional fees and related party insurance expense.

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**2012**

Revenue is derived primarily from management fees earned from the Capcos. Related party management fee revenue declined 27% or \$291,000 to \$776,000 for 2012 from \$1,067,000 for 2011. Related party management fees, which are eliminated upon consolidation, will continue to decline in the future as the Capcos mature and utilize their cash. If a Capco does not have current or projected cash sufficient to pay management fees, then such fees are not accrued.

Salaries and benefits decreased by 13% or \$752,000 for the year ended December 31, 2012 as compared to the prior year due to staff reductions in accounting, finance and executive personnel. The \$224,000 decline in professional fees during 2012 compared with 2011 was primarily related to a one-time payment in the prior year for costs related to securing a subtenant at the 1440 Broadway location. In addition, legal fees and accounting and audit fees also decreased in the current year. Depreciation and amortization decreased by \$45,000 year over year due to fixed assets becoming fully depreciated over the twelve month period. The decrease in other general and administrative costs of \$649,000 is primarily attributable to various one-time expenses incurred in 2011 including a \$236,000 bad debt charge related to an uncollectible loan, a \$250,000 accrual related to a contract dispute, and an accrual for commercial rent taxes. In addition, the Company continued to benefit through cost savings in connection with the corporate office relocation which occurred during the fourth quarter of 2011, including a credit to rent expense of approximately \$291,000 from the reduction in the accrued lease loss for the year ended December 31, 2012. Other decreases in IT costs, travel and office expenses were offset by an increase of \$33,000 in advertising and marketing expense, related to new national marketing campaigns designed to increase awareness of the Company as NEWTEK® *The Small Business Authority*. In sum, total expenses decreased \$2,966,000, or 26%, for the year ended December 31, 2012 as compared to the prior year.

**Table of Contents****Capco**

As described in Note 3 to the consolidated financial statements, effective January 1, 2008, the Company adopted fair value accounting for its financial assets and financial liabilities concurrent with its election of the fair value option for substantially all credits in lieu of cash, notes payable in credits in lieu of cash and prepaid insurance. These are the financial assets and liabilities associated with the Company's Capco notes that are reported within the Company's Capco segment. The tables below reflect the effects of the adoption of fair value measurement on the income and expense items (income from tax credits, interest expense and insurance expense) related to the revalued financial assets and liability for the years ended December 31, 2013, 2012 and 2011. In addition, the net change to the revalued financial assets and liability for the years ended December 31, 2013 and 2012 is reported in the line "Net change in fair market value of Credits in lieu of cash and Notes payable in credits in lieu of cash" on the consolidated statements of income.

The Company does not anticipate creating any new Capcos in the foreseeable future and the Capco segment will continue to incur losses going forward. The Capcos will continue to earn cash investment income on their cash balances and incur cash management fees and operating expenses. The amount of cash available for investment and to pay management fees will be primarily dependent upon future returns generated from investments in qualified businesses. Income from tax credits will consist solely of accretion of the discounted value of the declining dollar amount of tax credits the Capcos will receive in the future; the Capcos will continue to incur non-cash interest expense.

| (In thousands):  | 2013         | 2012         | 2011         | % Change     |              |
|--|--------------|--------------|--------------|--------------|--------------|
|  |              |              |              | 2013         | 2012         |
| <b>Revenue:</b>  |              |              |              |              |              |
| Income from tax credits  | \$ 113       | \$ 522       | \$ 1,390     | (78)%        | (62)%        |
| Interest income  | 29           | 40           | 42           | (28)%        | (5)%         |
| Dividend income related party  | 49           |              |              | 100%         |              |
| Other income   | 22           | 121          | 65           | (82)%        | 86%          |
| <b>Total revenue</b>   | <b>213</b>   | <b>683</b>   | <b>1,497</b> | <b>(69)%</b> | <b>(54)%</b> |
| <b>Net change in fair value of: Credits in lieu of cash and Notes payable in credits in lieu of cash</b> |              |              |              |              |              |
|  | 21           | 3            | (131)        | 600%         | (102)%       |
| <b>Expenses:</b>   |              |              |              |              |              |
| Interest expense   | 174          | 567          | 1,282        | (69)%        | (56)%        |
| Management fees related party  | 896          | 1,069        | 1,653        | (16)%        | (35)%        |
| Professional fees  | 296          | 293          | 438          | 1%           | (33)%        |
| Other general and administrative costs   | 152          | 158          | 190          | (4)%         | (17)%        |
| <b>Total expenses</b>  | <b>1,518</b> | <b>2,087</b> | <b>3,563</b> | <b>(27)%</b> | <b>(41)%</b> |
| Loss before income taxes   | \$ (1,284)   | \$ (1,401)   | \$ (2,197)   | (8)%         | (36)%        |

**2013**

Revenue is derived primarily from non-cash income from tax credits. The decrease in total revenue for the year ended December 31, 2013 versus 2012 reflects the effect of the declining dollar amount of tax credits remaining in 2013. The amount of future income from tax credits revenue will fluctuate with future interest rates. However, over future periods through 2016, the amount of tax credits and, therefore, the income the Company will recognize, will decrease to zero. Interest income decreased by \$11,000 for the twelve months ended December 31, 2013 to \$29,000 from \$40,000 due to a reduction in the average cash balance during 2013. In 2013, three of the Capcos made an equity investment in Small Business Lending, Inc., a related party, which earns a 10% annual cumulative preferred dividend. The Company recorded \$49,000 in accrued related party dividends from these investments for the year ended December 31, 2013. Other income decreased \$99,000, from \$121,000 to \$22,000 for the twelve months ended December 31, 2013 primarily due to a \$100,000 gain on the sale of an investment with a zero carrying basis recognized in 2012.

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For the year ended December 31, 2013, interest expense decreased by 69%, or \$393,000, from \$567,000 to \$174,000 as a result of the declining dollar amount of tax credits payable in 2013, and related party management fees decreased 16%, or \$173,000, to \$896,000. Related party management fees, which are eliminated upon consolidation, are expected to continue to decline in the future as the Capcos mature and utilize their cash.

## **2012**

Revenue is derived primarily from non-cash income from tax credits. The decrease in total revenue for the year ended December 31, 2012 versus 2011 reflects the effect of the declining dollar amount of tax credits remaining in 2012 partially offset by a \$100,000 gain on the sale of an investment with a zero carrying basis recognized in 2012. The amount of future income from tax credits revenue will fluctuate with future interest rates. However, over future periods through 2016, the amount of tax credits and, therefore, the income the Company will recognize, will decrease to zero.

Expenses consist primarily of management fees and non-cash interest expense. Related party management fees decreased 35%, or \$584,000, to \$1,069,000 for the twelve months ended December 31, 2012 from \$1,653,000 for the same period ended 2011. Related party management fees, which are eliminated upon consolidation, are expected to continue to decline in the future as the Capcos mature and utilize their cash. Interest expense decreased 56%, or \$715,000, from \$1,282,000 to \$567,000 for the year ended December 31, 2012 as a result of the declining dollar amount of tax credits payable in 2012. Professional fees decreased by \$145,000 from \$438,000 to \$293,000, between periods primarily due to a reduction in consulting fees related to one of our Capcos which is now decertified, and a decrease in audit fees which were lowered as a result of the reduced activity in this segment. Other expense declined as a result of a reduction of bank charges related to escrow accounts that were terminated over the course of 2012, as well as reductions in rent, filing fees and other miscellaneous expenses occurring as a result of the maturation of a number of Capcos.

## **Liquidity and Capital Resources**

### **Overview**

Cash requirements and liquidity needs over the next twelve months are anticipated to be funded primarily through operating results, available cash and cash equivalents, existing credit lines, proposed new credit lines, and additional securitizations of the Company's SBA lender's unguaranteed loan portions. As more fully described below, the Company's SBA lender ( NSBF ) will require additional funding sources to maintain current SBA loan originations in the latter part of 2014 under anticipated conditions; although the failure to find these sources may require the reduction in the Company's SBA lending and related operations, it will not impair the Company's overall ability to operate.

NSBF depends on the availability of purchasers for SBA loans held for sale transferred to the secondary markets and the premium earned therein to support its lending operations. At this time the secondary market for the SBA loans held for sale is robust.

NSBF has historically financed the operations of its lending business through loans or credit facilities from various lenders and will need to continue to do so in the future. Such lenders invariably require a security interest in the SBA loans as collateral which, under the applicable law, requires the prior approval of the SBA. If the Company should ever be unable to obtain the approval for its financing arrangements from the SBA, it would likely be unable to continue to make loans.

As an alternative to holding indefinitely the portions of SBA loans remaining after sale of the guaranteed portions in the SBA supervised secondary market, NSBF has undertaken to securitize these unguaranteed portions. In December 2010, the first such securitization trust established by NSBF issued notes to one investor in the amount of \$16,000,000 which received an S&P rating of AA. A second securitization, an amendment to the original transaction, was completed in December 2011, and resulted in an additional \$14,900,000 of notes issued to the same investor. NSBF used the cash generated from the first transaction to retire its outstanding term loan from Capital One, N.A. and to fund a \$3,000,000 account which during the first quarter of 2011 purchased unguaranteed portions originated subsequent to the securitization transaction. Similarly, the proceeds from the second securitization in 2011 were used to pay down its outstanding term loan with Capital One, N.A., and to fund a \$5,000,000 account used to fund additional originations in the first quarter of 2012. Additional securitizations were completed in March 2013 and December 2013 resulting in the issuance of notes in the amount of \$20,909,000 and \$24,434,000, respectively. Similarly, the proceeds of both transactions were used to pay down the outstanding term loan



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with Capital One, N.A. and a combined total of \$12,945,000 was used to fund an account used to purchase unguaranteed portions of loans throughout 2013, and during the first quarter of 2014. While this securitization process can provide a long-term funding source for the SBA lender, there is no certainty that it can be conducted on an economic basis. In addition, the securitization mechanism itself does not provide liquidity in the short term for funding SBA loans.

In December 2010, the SBA lender entered into a new revolving loan agreement with Capital One, N.A. for up to \$12,000,000 to be used to fund the guaranteed portions of SBA loans and to be repaid with the proceeds of the sale in the secondary market of those portions. Also, in June 2011, the SBA lender entered into a new revolving loan agreement with Capital One, N.A. for up to \$15,000,000 to be used to fund the unguaranteed portions of SBA loans and to be repaid with the proceeds of loan repayments from the borrowers as well as excess cash flow of NSBF. As a result of these two facilities, the SBA lender was able to increase the amount of loans it can fund at any one time.

In April 2010, the Company refinanced the existing line of credit between Capital One and NTS into a five year term loan for \$2,083,000.

Through February 28, 2011, the receivables financing unit, NBC, utilized a \$10,000,000 line of credit provided by Wells Fargo Bank to purchase and warehouse receivables. On February 28, 2011, NBC entered into a three year line of credit of up to \$10,000,000 with Sterling National Bank which replaced the Wells Fargo line. In December 2012, an amendment was signed providing that upon the achievement of certain profitability levels, the maximum amount of the line of credit under the Agreement can be increased from \$10,000,000 to \$15,000,000 at a later date upon NBC's request. The Amendment also extended the maturity date from February 28, 2014 to February 28, 2016. There is no cross collateralization between the Sterling lending facility and the Capital One term loan and credit facility; however, a default under the Capital One term loan or line of credit will create a possibility of default under the Sterling line of credit. The availability of the Sterling line of credit and the performance of the Capital One term loans are subject to compliance with certain covenants and collateral requirements as set forth in their respective agreements, as well as limited restrictions on distributions or loans to the Company by the respective debtor, none of which are material to the liquidity of the Company. At December 31, 2012, the Company and its subsidiaries were in full compliance with applicable loan covenants. The Company guarantees these loans for the subsidiaries up to the amount borrowed; in addition, the Company deposited \$750,000 with Sterling to collateralize the guarantee. As of December 31, 2012, the Company's unused sources of liquidity consisted of \$217,000 available through the Sterling National Bank line of credit.

In April 2012, the Company closed a \$15,000,000 credit facility with Summit comprised of a \$10,000,000 term loan, which was drawn at closing, and a \$5,000,000 delayed draw term loan to be made upon the satisfaction of certain conditions. The \$5,000,000 second tranche of this loan will not be drawn by the Company. The funds were used primarily for general corporate purposes including the origination of SBA 7(a) loans.

Restricted cash of \$16,877,000 as of December 31, 2013 is primarily held in NSBF and the Capcos. The majority, or \$12,830,000 of restricted cash, is related to NSBF, and includes \$6,330,000 held in a prefunding account to be used to originate new loans, \$3,242,000 for a reserve in the event payments are insufficient to cover interest and/or principal with respect to the securitization, and \$150,000 set aside for servicer and prepaid interest fees. The remaining \$3,108,000 represents payments collected due to participants and amounts owed to the SBA. For the Capcos, restricted cash can be used in managing and operating the Capcos, making qualified investments, to repay debt obligations, and for the payment of taxes on Capco taxable income. The Company also has \$2,475,000 in cash held in the companies aggregating our all other segment. The majority of these funds is held by PAY and represents monies held in the payroll escrow account. The remaining balance of \$1,572,000 includes \$750,000 in connection with the Sterling line of credit, and other amounts provided by sponsoring banks in connection with credit card processing and

by customers for insurance premiums.

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In summary, Newtek generated and used cash as follows:

|  | <b>For the Years Ended<br/>December 31,</b> |             |             |
|--|---|-------------|-------------|
|  | <b>2013</b>                                 | <b>2012</b> | <b>2011</b> |
| Net cash provided by (used in) operating activities  | \$ 4,974                                    | \$ (4,354)  | \$ 11,405   |
| Net cash used in investing activities                | (36,121)                                    | (22,498)    | (17,810)    |
| Net cash provided by financing activities            | 29,426                                      | 29,880      | 7,224       |
| Net (decrease) increase in cash and cash equivalents | (1,721)                                     | 3,028       | 819         |
| Cash and cash equivalents, beginning of year         | 14,229                                      | 11,201      | 10,382      |
| Cash and cash equivalents, end of year               | \$ 12,508                                   | \$ 14,229   | \$ 11,201   |

Net cash flows from operating activities increased \$9,328,000 to \$4,974,000 for the year ended December 31, 2013 compared to \$4,354,000 used during the year ended December 31, 2012. This change primarily reflects the decrease in broker receivable and increases in accounts payable and accrued expense during 2013. Broker receivables arise from loans traded but not settled before period end and represent the amount of cash due from the purchasing broker; the amount varies depending on loan origination volume and timing of sales at year end. For the year ended December 31, 2013, the Company originated \$135,168,000 of SBA loans held for sale and received proceeds from the sale of SBA loans of \$131,733,000, compared with \$83,349,000 of cash use for originations of SBA loans held for sale and \$84,743,000 in proceeds from the sale of SBA loans for the year ended December 31, 2012.

Net cash used in investing activities primarily includes the originations and repayments of the unguaranteed portions of SBA loans, purchase of fixed assets and customer accounts, changes in restricted cash and investments in qualified businesses. Net cash used in investing activities increased by \$13,623,000 to cash used of \$(36,121,000) for the year ended December 31, 2013 compared to cash used of \$(22,498,000) for the year ended December 31, 2012. The decrease was due primarily to a greater amount of SBA loans originated for investment during 2013, or \$42,885,000, versus \$24,190,000 in 2012.

Net cash provided by financing activities primarily includes the net borrowings and (repayments) on bank lines of credit and notes payable as well as securitization activities. Net cash provided by financing activities decreased by \$454,000 to cash provided of \$29,426,000 for the year ended December 31, 2013, from cash provided of \$29,880,000 for the year ended December 31, 2012. While the current year included cash provided of \$45,343,000 related to the Company's two securitization transactions in 2013, additional cash was used to repay bank lines of credit, a decrease of \$16,937,000 in cash during the year.

**Financing Activities**

Newtek historically obtained long-term financing to fund its investments and operations primarily through the issuance of notes to insurance companies through the Capco programs. Through December 31, 2013, Newtek has received in aggregate \$235,718,000 in proceeds from the issuance of long-term debt, Capco warrants, and Newtek common shares through the Capco programs. Newtek's Capcos last issued notes in 2005 and the Company does not anticipate participating in future Capco programs. In 2004, Newtek raised \$20,762,000 (net of related offering costs) in a secondary public offering. Newtek's principal funding requirements have been costs related to the Capco programs

(\$152,125,000), the acquisitions of NTS and NIA (the combination of which totaled \$9,836,000), investments in Capco qualified businesses, SBA 7(a) loans, receivable purchases, and working capital needs resulting from operating and business development activities of its consolidated operating entities. In July 2013, NSBF received an extension on the maturity of its warehouse line of credit of \$27 million, with Capital One, N.A. from September 30, 2013 to May 31, 2015, at which time the outstanding balance will be converted into a three-year term loan. The extension also included a provision which removed the sub-limits on the guaranteed and unguaranteed portions under the facility. In addition, the Company closed a \$15,000,000 Second Lien Credit Facility (the Facility) issued by Summit Partners Credit Advisors, L.P. (Summit), comprised of a \$10,000,000 term loan, which was drawn at closing, and a \$5,000,000 delayed draw term loan to be made upon the satisfaction of certain conditions. The \$5,000,000 was not drawn by the Company due to the inability of the Company to give Summit a security interest in the assets of NSBF, its SBA lender. As a result of these two facilities, as well as the Company's securitization activities discussed below, NSBF was able to increase the amount of loans it can fund at any one time. In December 2012, NBC amended its line of credit with Sterling National Bank (Sterling) which provided that upon the occurrence of certain events, the maximum amount of the line of credit under the Agreement can be increased from \$10,000,000 to \$15,000,000 at a later date upon NBC's request. The Amendment also extended the maturity date from February 28, 2014 to February 28, 2016.

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**Table of Contents****Credit Lines and Term Loans**

In July 2013 the SBA lender, received an extension on the maturity of its warehouse lines of credit, totaling \$27 million, with Capital One, N.A. from September 30, 2013 to May 31, 2015, at which time the outstanding balance will be converted into a three-year term loan. The extension also enhanced the terms of the credit facilities by removing the \$15 million funding sublimit for the non-guaranteed portions of the SBA 7(a) loans NSBF originates, and increasing the advance rate to 55% from 50% for the non-guaranteed portions of the SBA 7(a) loans. The NSBF line of credit is collateralized by all of NSBF's assets and Newtek guaranteed the repayment obligations. The interest rate on the portion of the facility collateralized by the government guaranteed portion of SBA 7(a) loans, is set at prime plus 1.00%, and there is a quarterly facility fee equal to 25 basis points on the unused portion of the revolving credit calculated as of the end of each calendar quarter. The interest rate on the portion of the facility collateralized by the non-guaranteed portion of SBA 7(a) loans, is set at prime plus 1.875%, and there is a quarterly facility fee equal to 25 basis points on the unused portion of the revolving credit calculated as of the end of each calendar quarter. The agreement includes financial covenants at the parent company level with its consolidated subsidiaries including a minimum fixed charge coverage ratio, minimum EBITDA requirements and minimum cash requirements held at Capital One. As of December 31, 2013, the Company and NSBF were in compliance with the financial covenants set in this line.

On April 26, 2012, the Company closed a \$15,000,000 Facility issued by Summit, comprised of a \$10,000,000 term loan, which was drawn at closing, and a \$5,000,000 delayed draw term loan to be made upon the satisfaction of certain conditions. The \$5,000,000 second tranche of this loan will not be drawn by the Company. The funds were used primarily for general corporate purposes including the origination of SBA 7(a) loans. The loan bears interest at 12.5% per annum on the amount outstanding plus payment-in-kind interest at 2.5%, which can either be paid quarterly in arrears or added to the outstanding loan amount. The Facility will mature in 5.5 years and can be prepaid without penalty at any time following the second anniversary of the closing date.

In addition to a second lien on all of the Company's assets behind the first lien held by Capital One, N.A., the principal lender to NSBF, Summit was given second-lien secured guarantees by each of the Company's principal subsidiaries: NTS and Universal Processing Services of Wisconsin, LLC, as well as certain other smaller subsidiaries. In addition, the Company issued to Summit a warrant representing the right to purchase 1,696,810 common shares, or 4.4% of the Company's current outstanding common equity. The warrant is exercisable at \$0.02 per share, included registration rights and anti-dilution protection, which has been subsequently removed. Summit is prohibited from selling any common shares it receives on exercise of the warrant for a period of 24 months following the closing; provided, however, that if the Company's common shares trade at or above \$2.25 per share for a period of fifteen consecutive days, Summit will have the ability to sell the common shares. Any sales by Summit will be subject to a right of first refusal in favor of the Company. The Facility calls for financial covenants such as minimum EBITDA, maximum capital expenditures, minimum unrestricted cash and cash equivalents, minimum tangible net worth and maximum leverage. As of December 31, 2013, the Company was in compliance with the financial covenants set in this line.

In February 2011, NBC entered into a three year line of credit with Sterling in an amount up to \$10,000,000. In December 2012, an amendment was signed providing that upon the occurrence of certain events, the maximum amount of the line of credit under the Agreement can be increased from \$10,000,000 to \$15,000,000 at a later date upon NBC's request. The Amendment also extended the maturity date from February 28, 2014 to February 28, 2016. This facility is and will be used to purchase receivables and for other working capital purposes. The interest rate is set at 5.00% or Prime plus 2.00%, whichever is higher, with interest on the line to be paid monthly in arrears. The line is and will be collateralized by the receivables purchased, as well as all other assets of NBC. The line is guaranteed by the Company; in addition, the Company deposited \$750,000 with Sterling to collateralize the guarantee. The agreement includes such financial covenants as minimum tangible net worth and maximum leverage ratio. The

Company is subject to meeting a maximum leverage ratio test and a future net loss test. As of December 31, 2013, the Company was in compliance with the financial covenants set in this line.

In April 2010 NTS closed a five year term loan with Capital One, N.A., which is collateralized by all of NTS's assets and Newtek guarantees the repayment obligations. The interest rate is variable based on the monthly London Interbank Offered Rate ( LIBOR ) rate plus 4.25% or Prime plus 2.25%, but no lower than 5.75%, with interest paid in arrears along with each monthly principal payment due. The agreement includes such financial covenants at the parent company level with its

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consolidated subsidiaries of a minimum fixed charge coverage ratio, minimum EBITDA requirements and minimum cash requirements held at Capital One. As of December 31, 2013, the Company was in compliance with the financial covenants set in this line.

**Securitization Transactions**

In December 2010, NSBF created a financing channel for the sale of the unguaranteed portions of SBA 7(a) loans held on its books. NSBF transferred the unguaranteed portions of SBA loans of \$19,615,000, and an additional \$3,000,000 in loans issued subsequent to the transaction, to a special purpose entity created for this purpose, Newtek Small Business Loan Trust 2010-1 (the Trust), which in turn issued notes (the securitization notes) for the par amount of \$16,000,000 against the assets in a private placement. The Trust is only permitted to purchase the unguaranteed portion of SBA 7(a) loans, issue asset-backed securities, and make payments on the securities. The Trust issued a single series of securitization notes to pay for the unguaranteed portions it acquired from NSBF and will be dissolved when those securities have been paid in full. The primary source for repayment of the securitization notes is the cash flows generated from the unguaranteed portion of SBA 7(a) loans now owned by the Trust; principal on the securitization notes will be paid by cash flow in excess of that needed to pay various fees related to the operation of the Trust and interest on the debt. The securitization notes have an expected maturity of about five years based on the expected performance of the underlying collateral and structure of the debt and a legal maturity of 30 years from the date of issuance. The assets of the Trust are legally isolated and are not available to pay NSBF's creditors. NSBF continues to retain rights to cash reserves and all residual interests in the Trust and will receive servicing income. Proceeds from this transaction were used to repay the Capital One, N.A. loan and for general corporate and lending purposes. Because the Company determined that as the primary beneficiary of the Trust it needed to consolidate the Trust into its financial statements, it continues to recognize the securitization notes in Notes payable. The investors and the Trust have no recourse to any of NSBF's other assets for failure if the Trust has insufficient funds to pay its obligations when due; however, NSBF's parent, Newtek, has provided a limited guaranty to the investors in the Trust in an amount not to exceed 10% of the original issuance amount (or \$1,600,000), to be used after all of the assets of the Trust have been exhausted. The notes were issued with an AA rating from S&P based on the underlying collateral.

In December 2011, NSBF entered into a Supplemental Indenture by which the original \$16,000,000 of securitization notes were amended to reflect a new principal amount of \$12,880,000, as a result of principal payments made, and additional notes were issued in an initial principal amount of \$14,899,000, so that the initial aggregate principal amount of all notes as of December 31, 2011 totaled \$27,779,000. The notes are backed by approximately \$40,500,000 of the unguaranteed portions of loans originated, and include an additional \$5,000,000 to be originated and issued to the Trust by NSBF under the SBA loan program. The notes retained their AA rating under S&P, and the final maturity date of the amended notes is March 22, 2037. The proceeds of the transaction have been and will be used to repay debt and originate new loans.

In March 2013, NSBF transferred the unguaranteed portions of SBA loans of \$23,569,000, and an additional \$5,900,000 in loans issued subsequent to the transaction, to a special purpose entity Newtek Small Business Loan Trust 2013-1 (the Trust). The Trust in turn issued securitization notes for the par amount of \$20,909,000 against the assets in a private placement. The notes received an A rating by S&P; and the final maturity date of the amended notes is June 25, 2038. The proceeds of the transaction have been and will be used to repay debt and originate new loans.

In December 2013, NSBF completed an additional transaction whereby the unguaranteed portions of SBA loans of \$23,947,000, and an additional \$3,642,000 in loans issued subsequent to the transaction, was transferred to a Trust. The Trust in turn issued securitization notes for the par amount of \$24,433,000 against the assets in a private placement. The notes received an A rating by S&P, and the final maturity date of the amended notes is April 25, 2039. The proceeds of the transaction have been and will be used to repay debt and originate new loans.





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The following chart represents Newtek's obligations and commitments as of December 31, 2013, other than Capco debt repayment discussed above, for future cash payments under debt, lease and employment agreements (in thousands):

| Contractual Obligations          | Total             | Payments due by period |                  |               |                   |
|----------------------------------|-------------------|------------------------|------------------|---------------|-------------------|
|                                  |                   | Less than 1 year       | 1-3 years        | 3-5 years     | More than 5 years |
| Bank Notes Payable (a)           | \$ 42,568         | 22,242(b)(c)           | 20,326(d)        |               |                   |
| Securitization Notes Payable (e) | 60,140            |                        |                  |               | 60,140            |
| Capital Leases                   | 642               | 235                    | 406              | 1             |                   |
| Operating Leases                 | 6,170             | 3,081                  | 2,142            | 841           | 106               |
| Employment Agreements            | 289               | 289                    |                  |               |                   |
| <b>Totals</b>                    | <b>\$ 109,809</b> | <b>\$ 25,847</b>       | <b>\$ 22,874</b> | <b>\$ 842</b> | <b>\$ 60,246</b>  |

(a) Interest rates range from 4.25% to 15.00%.

(b) Includes:

Capital One term note payable at NTS with an original balance of \$2,101,000 payable over a five year period commencing in 2010. As of December 31, 2013, the amount outstanding was approximately \$590,000.

(c) Includes:

\$21,261,000 Capital One guaranteed line and \$4,691,000 Capital One unguaranteed line, both of which are payable at SBF and are due May 31, 2015 and thereafter convert to a three year term loan. Also includes the \$10,000,000 Sterling line, which matures in February 2016. As of December 31, 2013, the combined amount outstanding on the Capital One lines was approximately \$25,951,000, and the balance outstanding on the Sterling line was \$6,026,000.

(d) Includes:

\$10,000,000, or \$8,650,000 net of discount, Second Lien Credit Facility issued by Summit Partners Credit Advisors, L.P

(e) Includes:

\$61,039,000, or \$60,140,000 net of discount, of securitization notes with a legal maturity of 30 years bearing interest at the rate of 3.90%; actual principal payments will be paid by cash flow in excess of that needed to pay various fees related to the operation of the Trust and interest on the debt.

**Financing Activities: Capcos**

We have deemphasized our Capco business in favor of growing our operating businesses and do not anticipate creating any new Capcos in the foreseeable future.

*Overview*

A Capco is either a corporation or a limited liability company established in and chartered by one of the nine jurisdictions that currently have authorizing legislation: Alabama, District of Columbia, Florida, Louisiana, Colorado, New York, Texas and Wisconsin (Missouri has an older program which pre-dates the start of our business and in which we do not participate). Aside from seed capital provided by an organizer such as Newtek, a Capco will issue debt and equity instruments exclusively to insurance companies and the Capcos are then authorized under the respective state statutes to make targeted equity or debt investments in companies. In some states, the law permits Capco investments in majority-owned or primarily controlled companies. In others, such as Louisiana, Colorado, Texas and the most recent programs in New York, there are some limitations on the percentage of ownership a Capco may acquire in a qualified business. In conjunction with the Capcos' investment in these companies, the Capcos may also provide loans to the companies. In most cases, the tax credits provided by the states are equal to the par amount of investment by the insurance companies in the securities of the Capcos, which can be utilized by them generally over a period of four to ten years. These credits are unaffected by the returns or lack of returns on investments made by the Capcos.

Our Capcos had arranged for the repayment of a portion of the Capco notes by The National Union Fire Insurance Company of Pittsburgh and The American International Specialty Lines Insurance Company, both affiliates of Chartis, Inc. As of December 31, 2013, all of the required cash payments have been made by these insurers for all of the Capcos. The balance of the repayment obligations for all of our Capcos will result from the availability to the investors of the state tax credits.

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### *Income from Capco Tax Credits*

In general, the Capcos issue debt and equity instruments to insurance company investors. For a description of the debt and equity instruments and warrants issued by Newtek's Capcos, see Note 2 in the Notes to the Consolidated Financial Statements. The Capcos then make targeted investments, as defined under the respective state/jurisdiction statutes, with the funds raised. Each Capco has a contractual arrangement with the particular state/jurisdiction that entitles the Capco to receive (earn) tax credits from the state/jurisdiction upon satisfying quantified, defined investment percentage thresholds and time requirements. In order for the Capcos to maintain their state or jurisdiction-issued certifications, the Capcos must make targeted investments in accordance with these requirements, which requirements are consistent with Newtek's overall business strategy. Each Capco statute provides specific rules and regulations under which the Capcos must operate. For example, the State of Louisiana program precludes the Capco from making controlling and majority-owned investments. Accordingly, investments made by the Louisiana Capco are considered portfolio companies and are majority-owned operated and controlled by their boards of directors and management. These portfolio companies operate independently of Newtek although Newtek participates on the board of directors of these companies (but in all cases we do not control a majority of the board of director positions unless there is a default under the terms of the investment) and makes available to them technology, services and products to sell.

Each Capco also has separate, contractual arrangements with the insurance company investors obligating the Capco to pay interest on the aforementioned debt instruments. The Capco may satisfy this interest obligation by delivering the tax credits or paying cash. The insurance company investors have the legal right to receive and use the tax credits and would, in turn, use these tax credits to reduce their respective state tax liabilities in an amount usually equal to 100% (110% in some cases in Louisiana) of their investments in the Capcos. The tax credits generally can be utilized over a four to ten-year period and in some instances are transferable and can be carried forward. Newtek's revenue from tax credits may be used solely for the purpose of satisfying the Capcos' obligations to the insurance company investors.

A description is set forth above of the manner in which Newtek and its Capcos account for the tax credit income. See Critical Accounting Policies Revenue Recognition.

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. The most significant estimates include:

allowance for loan losses;

sales and servicing of SBA loans;

chargeback reserves;

fair value measurement used to value certain financial assets and financial liabilities;

valuation of intangible assets and goodwill including the values assigned to acquired intangible assets;

stock-based compensation; and

income tax valuation allowance.

Management continually evaluates its accounting policies and the estimates it uses to prepare the consolidated financial statements. In general, the estimates are based on historical experience, on information from third-party professionals and on various other sources and assumptions that are believed to be reasonable under the facts and circumstances at the time such estimates are made. The Company's critical accounting policies are reviewed periodically with the audit committee of the board of directors. Management considers an accounting estimate to be critical if:

it requires assumptions to be made that were uncertain at the time the estimate was made; and

changes in the estimate, or the use of different estimating methods, could have a material impact on the Company's consolidated results of operations or financial condition.

Actual results could differ from those estimates. Significant accounting policies are described in Note 1 to the consolidated financial statements, which are included in Item 15 in this Form 10-K filing. In many cases, the accounting treatment of a particular transaction is specifically indicated by Accounting Principles Generally Accepted in the United States of America.

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Certain of our accounting policies are deemed critical, as they require management's highest degree of judgment, estimates and assumptions. The following critical accounting policies are not intended to be a comprehensive list of all of our accounting policies or estimates.

**Fair Value Measurements**

As discussed in Item 8. Financial Statements and Supplementary Data, Note 3, Fair Value Measurements we adopted fair value accounting effective January 1, 2008. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price) and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels for disclosure purposes. The Company carries its credits in lieu of cash, prepaid insurance and notes payable in credits in lieu of cash at fair value. The Company also carries impaired loans, servicing asset and other real estate owned at fair value. The fair value hierarchy gives the highest priority (Level 1) to quoted prices in active markets for identical assets or liabilities and gives the lowest priority to unobservable inputs (Level 3). An asset or liability's classification within the fair value hierarchy is based on the lowest level of significant input to its valuation. The levels of the fair value hierarchy are as follows:

- Level 1** Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain U.S. Government and agency mortgage-backed debt securities, corporate debt securities, derivative contracts and residential mortgage loans held-for-sale.
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly structured or long-term derivative contracts.

**Revenue Recognition**

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

are reported gross of amounts paid to sponsor banks.

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

**Income from tax credits:** Following an application process, a state will notify a company that it has been certified as a Capco. The state or jurisdiction then allocates an aggregate dollar amount of tax credits to the Capco. However, such amount is neither recognized as income nor otherwise recorded in the financial statements since it has yet to be earned by the Capco. The Capco is entitled to earn tax credits upon satisfying defined investment percentage thresholds within specified time requirements. Newtek has Capcos in seven states and the District of Columbia. Each statute requires that the Capco invest a threshold percentage of certified capital (the funds provided by the insurance company investors) in businesses defined as

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qualified within the time frames specified. As the Capco meets these requirements, it avoids grounds under the statute for its disqualification for continued participation in the Capco program. Such a disqualification, or decertification as a Capco results in a permanent recapture of all or a portion of the allocated tax credits. The proportion of the possible recapture is reduced over time as the Capco remains in general compliance with the program rules and meets the progressively increasing investment benchmarks. As the Capco progresses in its investments in Qualified Businesses and, accordingly, places an increasing proportion of the tax credits beyond recapture, it earns an amount equal to the non-recapturable tax credits and records such amount as income, with a corresponding asset called credits in lieu of cash in the balance sheet.

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

***Interest and SBA Loan Fees:*** Interest income on loans is recognized as earned. Loans are placed on non-accrual status if they exceed 90 days past due with respect to principal or interest and, in the opinion of management, interest or principal on individual loans is not collectible, or at such earlier time as management determines that the collectability of such principal or interest is unlikely. Such loans are designated as impaired non-accrual loans. All other loans are defined as performing loans. When a loan is designated as non-accrual, the accrual of interest is discontinued, and any accrued but uncollected interest income is reversed and charged against current operations. While a loan is classified as non-accrual and the future collectability of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding.

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

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

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

***Capco Debt Issuance:*** The Capco notes require, as a condition precedent to the funding of the notes, that insurance be purchased to cover the risks associated with the operation of its Capcos. This insurance has been purchased from Chartis Specialty Insurance Company and National Union Fire Insurance Company of Pittsburgh, both subsidiaries of Chartis, Inc. ( Chartis ), an international insurer. In order to comply with this condition precedent to the funding, the notes closing is structured as follows: (1) the certified investors wire their funds directly into an escrow account; (2) the escrow agent, pursuant to the requirements under the note and escrow agreement, automatically and

simultaneously funds the purchase of the insurance contract from the proceeds received. Newtek's Capco is not entitled to the use and benefit of the net proceeds received until the escrow agent has completed the purchase of the insurance. The Chartis insurance subsidiaries noted above are A+ credit rated by S&P.

Under the terms of this insurance, which is for the benefit of the certified investors, the Capco insurer incurs the primary obligation to repay the certified investors a substantial portion of the debt (including all cash payments) as well as to make compensatory payments in the event of a loss of the availability of the related tax credits. The Capco remains secondarily liable for such payments and must periodically assess the likelihood that it will become primarily liable and, if necessary, record a liability at that time. The parent company, Chartis, has not guaranteed the obligations of its subsidiary insurers, although it has committed to move the payment obligations to an affiliated company in the event the Capco insurer is materially downgraded in its credit rating.



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**Investment Accounting and Valuation:** The various interests that the Capcos and Newtek acquire as a result of their investments are accounted for under three methods: consolidation, equity method and cost method. The applicable accounting method is generally determined based on our voting interest in a company and whether the company is a variable interest entity where we are the primary beneficiary, and quarterly valuations are performed so as to keep our records current in reflecting the operations of all of its investments.

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

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

Companies not accounted for under the consolidation or the equity method of accounting are accounted for under the cost method of accounting, for which quarterly valuations are performed. Under this method, our share of the earnings or losses of such companies is not included in the consolidated statements of income, but the investment is carried at historical cost. In addition, cost method impairment charges are recognized as necessary, in the consolidated statements of income if circumstances suggest that this is an other than temporary decline in the value of the investment, particularly due to losses. Subsequent increases in value, if any, of the underlying companies are not reflected in our financial statements until realized in cash. We record as income amounts previously written off only when and if we receive cash in excess of its remaining investment balance.

On a quarterly basis, the investment committee of each Capco meets to evaluate each of our investments. Newtek considers several factors in determining whether an impairment exists on the investment, such as the companies' net book value, cash flow, revenue growth and net income. In addition, the investment committee looks at larger variables, such as the economy and the particular company's industry, to determine if an other than temporary decline in value exists in each Capco's and Newtek's investment.

**Impairment of Goodwill:** Management of the Company considers the following to be some examples of important indicators that may trigger an impairment review outside its annual goodwill impairment review: (i) significant under-performance or loss of key contracts acquired in an acquisition relative to expected historical or projected future operating results; (ii) significant changes in the manner or use of the acquired assets or in the Company's overall strategy with respect to the manner or use of the acquired assets or changes in the Company's overall business strategy; (iii) significant negative industry or economic trends; (iv) increased competitive pressures; (v) a significant decline in our stock price for a sustained period of time; and (vi) regulatory changes. In assessing the recoverability of our

goodwill and intangibles, we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. The fair value of an asset could vary, depending upon the estimating method employed, as well as assumptions made. This may result in a possible impairment of the intangible assets and/or goodwill, or alternatively an acceleration in amortization expense. For the years ended December 31, 2013 and 2012, the goodwill was determined to not be impaired.

**SBA Loans Held for Investment:** For loans that completed funding before October 1, 2010, SBA loans held for investment are reported at their outstanding unpaid principal balances adjusted for charge-offs, net deferred loan origination costs and the allowance for loan losses. For loans that completed funding on or after October 1, 2010, management elected to fair value SBA loans held for investment within the fair value hierarchy that prioritizes observable and unobservable inputs utilizing Level 3 unobservable inputs which reflect the Company's own expectations about the assumptions that market participants would use in pricing the asset (including assumptions about risk). Prior to 2013, the Company determined fair value based on its securitization pricing, as well as internal quantitative data on the portfolio with respect to historical default rates and future expected losses, and now uses a discounted cash flow method, which includes assumptions for cumulative default rates, prepayment speeds, servicing cost and a market yield. If a loan measured at fair value is subsequently impaired, then the fair value of the loan is measured based on the present value of expected future cash flows discounted at the loan's market interest rate, or the fair value less estimated costs to sell, of the collateral if the loan is collateral dependent. Because the loans bear interest at a variable rate, NSBF does not have to factor in interest rate risk.

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

For loans funded on or after October 1, 2010, the loan is reported at its fair value. Changes in the value of the loan, whether performing or impaired, are reported as a net change in the fair value of SBA loans held for investment.

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

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

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

**Troubled Debt Restructured Loans:** A loan is considered a troubled debt restructuring (TDR) when a borrower is experiencing financial difficulties that leads to a restructuring that the Company would not otherwise consider. Concessions per ASC Topic 310, Receivables, may include rate reductions, principal forgiveness, extension of the

maturity date and other actions to minimize potential losses. All TDRs are modified loans; however, not all modified loans are TDRs.

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

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**SBA Loans Held for Sale:** For guaranteed portions funded, but not yet traded at each measurement date, management elected to fair value SBA loans held for sale within the fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value utilizing Level 2 assets. These inputs include debt securities with quoted prices that are traded less frequently than exchange-traded instruments or have values determined using a pricing model with inputs that are observable in the market. The secondary market for the guaranteed portions is extremely robust with broker dealers acting as primary dealers. NSBF sells regularly into the market and can quickly price its loans held for sale. The Company values the guaranteed portion based on observable market prices for similar assets.

**Securitization Activities:** NSBF engaged in securitizations of the unguaranteed portions of its SBA 7(a) loans. Because the transfer of these assets did not meet the criteria of a sale, these transactions were treated as a secured borrowings. NSBF continues to recognize the assets of the secured borrowing in loans held for investment and recognize the associated financing in Note payable Securitization trust VIE.

**Sales and Servicing of SBA Loans:** NSBF originates loans to customers under the SBA program that generally provides for SBA guarantees of 50% to 90% of each loan, subject to a maximum guarantee amount. This guaranteed portion is generally sold to a third party via an SBA regulated secondary market transaction utilizing SBA Form 1086 for a price equal to the guaranteed loan amount plus a premium that includes both an upfront cash payment and the fair value servicing assets recorded in conjunction with the loan sale. Prior to October 1, 2010, NSBF recognized the revenue item Premium on loan sales net of capitalized loan expenses and the discount on the retained unguaranteed portion; subsequent to the adoption of fair value of SBA 7(a) loans on October 1, 2010, NSBF recognizes premium on loan sales as equal to the cash premium plus the fair value of the servicing asset. Revenue is recognized on the trade date of the guaranteed portion.

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

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

Management's impairment analysis indicated no valuation adjustment for 2013 and 2012.

**Share-Based Compensation.** The Company records all share-based payments to employees based on their fair values using an option-pricing model at the date of grant.

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

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**New Accounting Standards**

In July 2013, the FASB issued ASU No. 2013-11: Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ( ASU 2013-11 ). The amendments in ASU 2013-11 are intended to end inconsistent practices regarding the presentation of unrecognized tax benefits on the balance sheet. An entity will be required to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss ( NOL ) or tax credit carryforward whenever the NOL or tax credit carryforward would be available to reduce the additional taxable income or tax due if the tax position is disallowed. This standard became effective for annual reporting periods beginning after December 15, 2013, and did not have a material impact on the Company's Consolidated Financial Statements or disclosures.

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

**Subsequent Events**

The Company has evaluated subsequent events through the time of filing these consolidated financial statements with the SEC.

**Off Balance Sheet Arrangements**

None.

**Impact of Inflation**

The impact of inflation and changing prices on our results of operations is not material.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

We consider the principal types of risk in our business activities to be fluctuations in interest rates and loan portfolio valuations and the availability of the secondary market for our SBA loans held for sale. Risk management systems and procedures are designed to identify and analyze our risks, to set appropriate policies and limits and to continually monitor these risks and limits by means of reliable administrative and information systems and other policies and programs.

Our SBA lender primarily lends at an interest rate of prime, which resets on a quarterly basis, plus a fixed margin. Our receivable financing business purchases receivables priced to equate to a similar prime plus a fixed margin structure. The Capital One term loan and revolver loan, the securitization notes and the Sterling line of credit are on a prime plus a fixed factor basis. As a result the Company believes it has matched its cost of funds to its interest income in its financing activities. However, because of the differential between the amount lent and the smaller amount financed a

significant change in market interest rates will have a material effect on our operating income. In periods of sharply rising interest rates, our cost of funds will increase at a slower rate than the interest income earned on the loans we have made; this should improve our net operating income, holding all other factors constant. However, a reduction in interest rates, as has occurred since 2008, has and will result in the Company experiencing a reduction in operating income; that is interest income will decline more quickly than interest expense resulting in a net reduction of benefit to operating income.

Our lender depends on the availability of secondary market purchasers for the guaranteed portions of SBA loans and the premium received on such sales to support its lending operations. At this time the secondary market for the guaranteed portions of SBA loans is robust but during the 2008 and 2009 financial crisis the Company had difficulty selling its loans for a premium; although not expected at this time, if such conditions did recur our SBA lender would most likely cease making new loans and could experience a substantial reduction in profitability.

We do not have significant exposure to changing interest rates on invested cash which was approximately \$29,385,000 at December 31, 2013. We do not purchase or hold derivative financial instruments for trading purposes. All of our transactions are conducted in U.S. dollars and we do not have any foreign currency or foreign exchange risk. We do not trade commodities or have any commodity price risk.



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We believe that we have placed our demand deposits, cash investments and their equivalents with high credit-quality financial institutions. Invested cash is held almost exclusively at financial institutions with ratings from S&P of A- or better. The Company invests cash not held in interest free checking accounts or bank money market accounts mainly in U.S. Treasury only money market instruments or funds and other investment-grade securities. As of December 31, 2013, cash deposits in excess of FDIC and SIPC insurance totaled approximately \$10,802,000 and funds held in U.S. Treasury only money market funds or equivalents in excess of SIPC insurance totaled approximately \$44,000.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

Our consolidated financial statements and related notes begin on Page F-1, which are included in this Annual Report on Form 10-K.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

(a) On May 23, 2013, the Company acting through its Board of Directors and the Audit Committee of the Board terminated the services of CohnReznick LLP, its previous independent accountant.

The reports prepared by CohnReznick LLP on the financial statements of the Company for the past two years and any subsequent interim period did not contain an adverse opinion or disclaimer of opinion, or qualification or modification as to uncertainty, audit scope or accounting principles. During said two year period and any subsequent interim period there were (i) no disagreements between CohnReznick LLP and the Company on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure which, if not resolved to CohnReznick LLP's satisfaction, would have caused it to make reference to the subject matter of the disagreement in connection with its report on the Company's financial statements for such period; and (ii) no reportable events as the term is described in Item 304(a)(1)(iv) of Regulation SK.

A copy of this disclosure has been provided to CohnReznick LLP for its review prior to its filing with the Commission and the Company has asked that it furnish the Company with a letter addressed to the Securities and Exchange Commission containing any new information, clarification of the Company's expression of their views, or the respects in which it does not agree with the statements made above. A copy of that letter, dated May 23, 2013, was filed as Exhibit 16.1 to the Current Report on Form 8K as filed on May 28, 2013.

(b) On May 23, 2013, the Company acting through its Board of Directors and the Audit Committee of the Board authorized the engagement of the firm of McGladrey LLP ( McGladrey ) as its independent accountant. During the fiscal years ended December 31, 2012 and 2011 and through May 23, 2013, the Company has not consulted with McGladrey regarding either (i) the application of accounting principles to any specified transaction, either completed or proposed; or the type of audit opinion that might be rendered on the Company's consolidated financial statements or (ii) any matter that was either the subject of a disagreement (as defined in Item 304(a)(1)(iv) of Regulation S-K and the related instructions thereto), or a reportable event (as defined in Item 304(a)(1)(v) of Regulation S-K).

**ITEM 9A. CONTROLS AND PROCEDURES.**

***a) Evaluation of Disclosure Controls and Procedures.***

Our management, with the participation of our Chief Executive Officer (Principal Executive Officer) and Chief Accounting Officer (Principal Financial Officer), evaluated the effectiveness of our disclosure controls and procedures

as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer (Principal Executive Officer) and Chief Accounting Officer (Principal Financial Officer) concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report and provide reasonable assurance that the information required to be disclosed by us in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

***(b) Change in Internal Control over Financial Reporting.***

No change in our internal control over financial reporting occurred during the quarter ended December 31, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

***(c) Limitations.***

A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurances that the control system's objectives will be met. Furthermore, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with its policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. We periodically evaluate our internal controls and make changes to improve them.

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**MANAGEMENT'S REPORT TO THE STOCKHOLDERS OF NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES**

**Management's Report on Internal Control Over Financial Reporting**

As management, we are responsible for establishing and maintaining adequate internal control over financial reporting for Newtek Business Services, Inc. and its subsidiaries. In order to evaluate the effectiveness of internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002, we have conducted an assessment, including testing, using the criteria in *Internal Control-Integral Framework* issued by the Committee of Sponsoring Organization of the Treadway Commission (COSO). Newtek Business Services, Inc.'s system of internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Because of its inherent limitation, internal control over financial reporting may not prevent or detect misstatements.

Based on our assessment, we have concluded that Newtek Business Services, Inc. maintained effective internal control over financial reporting as of December 31, 2013, based on criteria in *Internal Control-Integrated Framework* issued by the COSO. As a smaller reporting company, the effectiveness of Newtek Business Services, Inc.'s internal control over financial reporting is not required to be audited by our independent registered public accounting firm.

This Annual Report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this Annual Report.

**ITEM 9B. OTHER INFORMATION.**

None

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.**

The following is a brief summary of the background of each of our directors, which includes specific information about each director's experience, qualifications, attributes or skills that led the board to the conclusion that the individual is qualified to serve on our board, in light of our business and structure.

**David C. Beck**

**Age: 71**

**Director since: 2002**

Mr. Beck has been Managing Director of Copia Capital, LLC (Copia), a private equity investment firm, since September 1998. Prior to founding Copia, Mr. Beck was CEO of Universal Savings Bank, Milwaukee, WI and First Interstate Corporation of Wisconsin, a publicly traded company. Mr. Beck also served as Chairman of Universal Savings Bank's holding company, Universal Saving Banc Holdings, Inc., from November 2002 until September 2009. He is a certified public accountant. Mr. Beck's more than 30 years' experience in the financial services industry qualifies him to serve on our board of directors. His experience and insight gained as a managing director of a private equity firm also provide a significant addition to the board of directors.

**Sam Kirschner**

**Age 65**

**Director since: 2010**

Mr. Kirschner has, since he co-founded MayerCap, LLC in 2003, been a Managing Member of the company. MayerCap, LLC manages investments in hedge funds, as a fund-of-funds, and is headquartered in New York City. MayerCap, LLC places particular emphasis on investing in newer and smaller hedge funds. Mr. Kirschner has also been since 1986 president of Nexus Family Business Consulting where he has specialized in advising owners, boards and senior executive of major family-owned businesses and large domestic and foreign banks on matters of succession planning, estate planning and strategic mergers and acquisitions. He has also consulted on the identification and recruitment of senior executives. Mr. Kirschner holds a Ph.D. in clinical psychology and has taught at both New York University School of Continuing & Professional Studies and the Wharton School of Business at the University of Pennsylvania. Mr. Kirschner has many years of experience in working with small to medium sized firms and addressing the many issues which they face in growing their businesses. He is also very well versed in the latest developments in the social media area and has been very helpful in advising the Company on its product development and social media initiatives and this experience provides a significant addition to the board of directors.

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**Table of Contents****Salvatore F. Mulia****Age: 66****Director since: 2005**

Mr. Mulia has been a financial advisor at RTM Financial Services, Westport, CT, with an emphasis on leasing and lending advisory services since February 2003. From February 2001 to February 2003 Mr. Mulia was Executive Vice President of Pitney Bowes Capital Corp, Shelton, CT which was engaged in providing financial services to business customers. Prior to that, Mr. Mulia held senior management positions within General Electric's Financial Services Division, GE Capital Corporation ( GECC ), and from 1980 through 1993 he was responsible for developing new products and business initiatives in financial services. During his tenure at GECC Mr. Mulia was a principal in GEVEST, GECC's investment banking unit, where he headed syndication and led acquisition teams which acquired leasing companies with combined assets of \$3 billion including: TransAmerica Leasing, Chase Manhattan's leasing subsidiary and LeaseAmerica. Mr. Mulia has many years of experience with major financial companies working with smaller to mid-sized companies needing capital and debt. His understanding of the dynamics of these businesses has been particularly helpful in addressing similar issues of the Company and this experience provides a significant addition to the board of directors.

**Barry Sloane****Age: 54****Director since: 1999**

Mr. Sloane is the Chairman of the Board of Directors, Chief Executive Officer and President of the Company and has been an executive officer of each of the Company-sponsored certified capital companies for more than five years. From September 1993 through July 1995, Mr. Sloane was a Managing Director of Smith Barney, Inc. While there, he directed the Commercial and Residential Real Estate Securitization Unit, and he was national sales manager for institutional mortgage and asset backed securities sales. From April 1991 through September 1993, Mr. Sloane was founder and President of Aegis Capital Markets, a consumer loan origination and securitization business which was eventually taken public with the name of Aegis Consumer Funding. From October 1988 through March 1991, Mr. Sloane was Senior Vice President of Donaldson, Lufkin and Jenrette, where he was responsible for directing sales of mortgage-backed securities. From August 1982 to September 1988 Mr. Sloane was a senior mortgage security salesman and trader for Bear Stearns, L.F. Rothschild, E.F. Hutton and Paine Webber. Mr. Sloane's broad business and financial experience and his knowledge of the Company's businesses has been of great value to the other members of the board.

**The Board and Board Meetings**

Newtek's Board of Directors and management are committed to responsible corporate governance to ensure that the Company is managed for the long-term benefit of its shareholders. To that end, the Board of Directors and management periodically review and update, as appropriate, the Company's corporate governance policies and practices. In doing so, the Board and management review published guidelines and recommendations of institutional shareholder organizations and current best practices of similarly situated public companies. The Board of Directors and management also regularly evaluate and, when appropriate, revise the Company's corporate governance policies and practices in accordance with the requirements of the Sarbanes-Oxley Act of 2002 and the rules and listing standards issued by the SEC and The NASDAQ® Stock Market, Inc. ( NASDAQ ) where the Company's Common Shares are listed and traded.

During the fiscal year ended December 31, 2013, the Board of Directors held a total of seven meetings. Each director attended at least 75% of the total number of meetings of the Board of Directors and at least 75% of the meetings of all committees on which he served.

**Corporate Governance Guidelines**

The Company has adopted corporate governance guidelines titled "Governance Guidelines" which are available at the Investor Relations page of [www.thesba.com](http://www.thesba.com). The Governance Guidelines are also available in print to any shareholder who requests them. These principles were adopted by the Board of Directors to best ensure that the Board is independent from management, that the Board adequately performs its function as the overseer of management and to help ensure that the interests of the Board and management align with the interests of the shareholders.

On an annual basis, each director and executive officer is obligated to complete a Directors and Officers Questionnaire which requires disclosure of any transactions with the Company in which the Director or executive officer, or any member of his or her immediate family, have a direct or indirect material interest.

#### **Committees of the Board of Directors**

The Board of Directors currently has two standing committees: the Audit Committee and the Compensation, Corporate Governance and Nominating Committee. Each member of these committees is independent as defined by applicable NASDAQ and SEC rules. Each of the committees has a written charter approved by the Board of Directors, which is available the Investor Relations page of on our website at [www.thesba.com](http://www.thesba.com).

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The Board of Directors Audit Committee consists of Messrs. Beck as Chair, Mulia and Kirschner and operates pursuant to its written charter. The Audit Committee held 10 meetings during the year ended December 31, 2013. The Audit Committee is authorized to examine and approve the audit report prepared by the independent auditors of the Company, to review and select the independent auditors to be engaged by the Company, to review the internal audit function and internal accounting controls and to review and approve conflict of interest or related party transactions and audit policies.

Director Beck, Chair of the Audit Committee, has been determined by the Board of Directors to be a financial expert and independent under applicable rules of the SEC and NASDAQ. In addition, the Board of Directors has determined that all members of the audit committee are financially literate as that term is defined by applicable NASDAQ and SEC rules.

The Company's Compensation, Corporate Governance and Nominating Committee consists of Messrs. Mulia, as Chair, Beck and Kirschner, all of whom are non-employee directors within the meaning of the SEC rules. The Compensation, Corporate Governance and Nominating Committee evaluates the compensation and benefits of the directors, officers and employees, recommends changes, and monitors and evaluates employee performance. The Compensation, Corporate Governance and Nominating Committee did not meet during the year ended December 31, 2013 as meetings were scheduled in late 2012 or early 2014 to address compensation and bonus matters for the 2013 year. The Compensation, Corporate Governance and Nominating Committee is generally responsible for identifying corporate governance issues, creating corporate governance policies, identifying and recommending potential candidates for election to the Board and reviewing executive and director compensation and performance.

## **Director Independence**

The Board of Directors is required by the Governance Guidelines to have a majority of members who meet the applicable independence requirements of the NASDAQ and any applicable rule or law. Each of the following non-employee directors is independent and has no relationship to the Company, except as a director and shareholder.

### **David C. Beck**

### **Salvatore F. Mulia**

### **Sam Kirschner**

The Board of Directors has determined that each of its directors, with the exception of Mr. Sloane, qualifies as independent as defined by applicable NASDAQ and SEC rules. In making this determination, the Board has concluded that none of these members has a relationship which, in the opinion of the Board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. It is the policy of the Board of Directors to hold executive sessions of the independent directors meeting without management at regular intervals and as requested by a director. David C. Beck presides over these meetings of the independent directors. All members of the Board of Directors are encouraged to attend the Annual Meeting of Shareholders. In 2013, Mr. Sloane attended the Annual Meeting of shareholders and, Mr. Kirschner, Mr. Beck and Mr. Mulia attended by telephone.

## **Leadership Structure**

Mr. Sloane has served as Chairman and Chief Executive Officer since 1999 and as President since 2008. We continue to believe that our leadership structure is appropriate since Mr. Sloane has over 25 years of experience in our industry or related businesses, and under his leadership our management team has executed a strategy that has significantly

improved our earnings growth, cash flow stability and competitiveness.

### **Board Risk Oversight**

While management is responsible for identifying, assessing and managing risk, our Board is responsible for risk oversight with a focus on the most significant risks facing the company. The Board's risk oversight includes, but is not limited to, the following risks:

strategic;

operational;

compliance; and

reputational.

At the end of each year, management and the Board jointly develop a list of major risks that the company prioritizes in the following year. In 2013 the Board focused on the following areas of risk:

management compensation;



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determining Newtek's long-term growth;

strategic and operational planning, including acquisitions and the evaluation of the Company's capital structure and long term debt financing; and

legal and regulatory compliance.

The Board has delegated responsibility for the oversight of specific risks to Board committees. The Audit committee oversees risks associated with

the Company's financial statements and financial reporting;

mergers and acquisitions;

internal controls over financial reporting;

credit and liquidity;

information technology; and

security and litigation issues.

The Compensation, Governance and Nominating committee considers the risks associated with:

compensation policies and practices;

management resources, structure, succession planning and management development;

overall governance practices and the structure and leadership of the Board; and

related person transactions and the code of conduct for all employees, officers and directors.

The Board is kept informed of each committee's risk oversight and any other activities deemed to engender risk via periodic reports from management and the committee chairs. Our Board recognizes the importance of risk oversight, and its role is consistent with the Board's leadership structure, the CEO and the senior management of the Company. Our senior management is responsible for assessing and managing risk exposure and the Board and committees of the Board provide the oversight consistent with those efforts.

## **Director Nominations**

In considering whether to recommend any particular candidate for inclusion in the Board of Directors' slate of recommended director nominees, the Compensation, Corporate Governance and Nominating Committee applies the criteria set forth in the Governance Guidelines. These criteria include the candidate's integrity, business acumen, knowledge of our business and industry, experience, diligence, absence of conflicts of interest and the ability to act in the interest of all shareholders. The committee does not assign specific weights to particular criteria, and no particular criterion is a prerequisite for each prospective nominee. We believe that the backgrounds and qualifications of our directors, considered as a group, should provide a composite mix of experience, knowledge and abilities that will best allow the Board to fulfill its responsibilities.

Shareholders may recommend individuals to the Compensation, Corporate Governance and Nominating Committee for consideration as potential director candidates by submitting their names, together with appropriate biographical information and background materials. The recommendation should be sent to the Compensation, Corporate Governance and Nominating Committee, c/o Matthew G. Ash, Secretary, Newtek Business Services, Inc., 212 West 35th Street, 2nd floor, New York, New York 10001. Assuming that appropriate biographical and background material has been provided on a timely basis, the committee will evaluate shareholder-recommended candidates by following substantially the same process, and applying substantially the same criteria, as it follows for candidates recommended by our Board or others. If the Board of Directors determines to nominate a shareholder-recommended candidate and recommends his or her election, then his or her name will be included in the proposal for election for the next annual meeting.

Shareholders also have the right under our Bylaws to nominate director candidates, without any action or recommendation on the part of the Compensation, Corporate Governance and Nominating Committee or the Board, by following the procedures set forth under "Shareholder Proposals" in our proxy statement. Candidates nominated by shareholders in accordance with the procedures set forth in our Bylaws may be included in our proxy statement and solicitation for the next annual meeting.

## **Compensation Committee Interlocks and Insider Participation**

All members of the Compensation, Corporate Governance and Nominating Committee are independent directors, and none of them are present or past employees or paid officers of ours or any of our subsidiaries. No member of the Compensation, Corporate Governance and Nominating Committee has had any relationship with us requiring disclosure under Item 404 of Regulation S-K. None of our executive officers has served on the board or compensation committee (or other committee serving an equivalent function) of any other entity, one of whose executive officers has served on our Board or Compensation, Corporate Governance and Nominating Committee.

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### **Our Code of Ethics**

We have adopted a code of ethics, referred to as our Code of Conduct, which applies to all directors and employees, including the principal executive, financial and accounting officers. A copy of the Code of Conduct will be made available upon request directed to the executive offices of the Company and may be viewed on the Investor Relations page of on our web site [www.thesba.com](http://www.thesba.com). In addition, we post on our website all disclosures that are required by law or NASDAQ listing standards concerning any amendments to, or waivers from, any provision of the Code. We also post on our website any amendments to, or waivers from, our Code of Conduct and Ethics that apply to our principal executive officer and principal financial and accounting officer.

The Audit Committee or the Board of Directors reviews all potential related party transactions on an ongoing basis, and all such transactions must be approved by the Audit Committee or the Board of Directors. We have not adopted written procedures for review of, or standards for approval of, these transactions, but instead the Audit Committee or the Board of Directors intends to review such transactions on a case by case basis. In addition, the Compensation, Corporate Governance and Nominating Committee or the Board of Directors reviews and approves all compensation-related policies involving our directors and executive officers.

The Company pays gross residuals to an independent sales organization ( ISO ) controlled by a major shareholder and former president of the Company, Jeffrey G. Rubin. The ISO earns gross residual payments on the merchant processing revenue generated for the Company, and in turn pays commissions to its sales representatives as well as other operating expenses. Gross residuals paid by the Company to the ISO for the years ended December 31, 2013, 2012 and 2011 were approximately \$3,636,000, \$3,155,000 and \$1,649,000, respectively. We anticipate that Mr. Rubin and his related entities will continue to earn gross residual profits on the merchant processing revenue he generated for the Company in 2014.

### **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Exchange Act requires our directors and executive officers and persons who own more than 10% of a registered class of our equity securities, to file with the SEC and the NASDAQ initial reports of ownership and reports of changes in ownership of Common Shares of the Company. Officers, directors and greater than 10% shareholders are required by SEC regulations to furnish us with copies of all Section 16(a) forms they file.

To the Company's knowledge, based solely on Forms 3 and 4, and amendments to such forms, provided to the Company by its directors and executive officers and greater than 10% shareholders during 2013, all such required reports were timely filed.

### **Director Compensation**

The Board has adopted a plan for compensation of non-employee directors which gives effect to the time and effort required of each of them in the performance of their duties. During 2013 compensation was paid in cash and restricted stock and is set forth in the table below. Since November 10, 2010, Directors are paid the following annual fees:

for participation on the Board: \$50,000;

as chair of a Committee: \$20,000;

as a committee member: \$5,000.

**Director Summary Compensation Table <sup>(1)</sup>**

|                    | <b>Fees<br/>Earned<br/>or Paid<br/>in<br/>Cash<br/>(\$)</b> | <b>Stock<br/>Awards<br/>(\$)</b> | <b>Option<br/>Award<br/>(\$)</b> | <b>Non-Equity<br/>Incentive<br/>Plan<br/>Compensation<br/>(\$)</b> | <b>Nonqualified<br/>Deferred<br/>Compensation<br/>Earnings<br/>(\$)</b> | <b>All<br/>Other<br/>Compensation<br/>(\$)</b> | <b>Total<br/>(\$)</b> |
|--------------------|---|----------------------------------|----------------------------------|--|---|--|-----------------------|
| David C. Beck      | 75,000  | 45,750                           |                                  |  |   |  | 120,750               |
| Salvatore F. Mulia | 75,000  | 45,750                           |                                  |  |   |  | 120,750               |
| Sam Kirschner      | 60,000  | 45,750                           |                                  |  |   |  | 105,750               |

- (1) Barry Sloane, the Company's Chairman, Chief Executive Officer and President, is not included in this table as he was an employee of the Company in 2013 and thus received no compensation for his services as a Director. The compensation received by Mr. Sloane as an employee of the Company is shown in the Summary Compensation Table below.

**Table of Contents****ITEM 11. EXECUTIVE COMPENSATION**

The executive officers of Newtek, and their ages, as of December 31, 2013, are as follows:

| <b>Name</b>       | <b>Age</b> | <b>Position</b>                                     |
|-------------------|------------|---|
| Barry Sloane      | 54         | Chairman, Chief Executive Officer, and Secretary    |
| Craig J. Brunet   | 65         | Executive Vice President, Chief Information Officer |
| Jennifer Eddelson | 41         | Executive Vice President, Chief Accounting Officer  |

**Barry Sloane** is the Chairman of the Board, Chief Executive Officer, and Secretary of the Company and has been an executive officer of each of the Company-sponsored certified capital companies for more than five years. Previously, from September 1993 through July 1995, Mr. Sloane was a Managing Director of Smith Barney, Inc. While there, he directed the Commercial and Residential Real Estate Securitization Unit and, prior to that time, he was national sales manager for institutional mortgage and asset backed securities sales. From April 1991 through September 1993, he was founder and President of Aegis Capital Markets, a consumer loan origination and securitization business which was eventually taken public with the name of Aegis Consumer Funding. From October 1988 through March 1991, Mr. Sloane was Senior Vice President of Donaldson, Lufkin and Jenrette, where he was responsible for directing sales of mortgage-backed securities. From August 1982 to September 1988 Mr. Sloane was a senior mortgage security salesman and trader for Bear Stearns, L.F. Rothschild, E.F. Hutton and Paine Webber.

**Craig J. Brunet** has served as Executive Vice President and Chief Information Officer since January 1, 2012. Mr. Brunet previously served as Executive Vice President Strategic Planning and Marketing since July, 2006 and as Chairman and Chief Executive Officer of the Company's Harvest Strategies subsidiary since June, 2001. From 1984-1989, Mr. Brunet served as Director of Strategic Planning for AT&T, where he managed all special development and modifications to standard AT&T products to include non-standard pricing, terms and conditions, hardware and software strategic initiatives, FCC Tariffs, as well as joint venture and/or integration requirements for the top 50 AT&T accounts. In 1989, Mr. Brunet joined Entergy Corporation as Executive Vice President responsible for managing and directing the overall Entergy System retail and wholesale marketing effort including strategy development, policy preparation and administration, market development and market analysis and research. During his tenure with Entergy, he served as Chairman of the Strategic Planning Committee of the Electric Power Research Institute (EPRI) and served on the Board of Directors of Entergy Enterprises guiding decisions on unregulated activities including strategic acquisition and investments in generation, distribution and new technology assets domestically and internationally. From 1993-1996, Mr. Brunet served as Chairman, CEO and President of First Pacific Networks, a leader in the initial development and deployment of broadband technologies in the United States and Europe. During this period, he was also Chairman of the Board of Credit Depot Corporation, a publicly traded multi-state mortgage company and served as Chairman of both the audit committee and compensation committee.

**Jennifer Eddelson** is a certified public accountant licensed in the state of New York and has served as Executive Vice President and Chief Accounting Officer of Newtek Business Services, Inc. since July 1, 2011. Previously Jennifer was employed by the Company since 2004 as Corporate Controller, Vice President of Financial Reporting since 2006, and in these and her current capacities has had a principal responsibility for the development and implementation of the Company's accounting policies and practices. Previously, Ms. Eddelson practiced as a certified public accountant for eight years with Janover, LLC, a public accounting firm located in New York, primarily in the audit and tax area. Ms. Eddelson is a member of the NYS Society of CPAs and a member of the AICPA.



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The individuals who served as the Company's Chief Executive Officer, Chief Information Officer and Chief Accounting Officer during 2013, as well as the other individuals included in the Summary Compensation Table below, are referred to below as the named executive officers.

### **Compensation Philosophy and Objectives**

All of our compensation programs are designed to attract and retain key employees and to motivate them to achieve, and reward them for achieving, superior performance. Different programs are geared to shorter- and longer-term performance, with the goal of increasing shareholder value over the long-term. Executive compensation programs impact all employees by setting general levels of compensation and helping to create an environment of goals, rewards and expectations. Because we believe the performance of every employee is important to our success, we are mindful of the effect of executive compensation and incentive programs on all of our employees.

We believe that the compensation of our executives should reflect their success as a management team, rather than just as individuals, in attaining key operating objectives, such as growth of sales, growth of operating earnings and earnings per share and growth or maintenance of market share and long-term competitive advantage, and ultimately, in attaining an increased market price for our stock. We believe that the performance of our executives in managing our Company, considered in light of general economic and specific company, industry and competitive conditions, should be the basis for determining their overall compensation. We also believe that their compensation should not be based on the short-term performance of our stock, whether favorable or unfavorable, but rather that the price of our stock will, in the long-term, reflect our operating performance and, ultimately, the management of the Company by our executives. We seek to have the long-term performance of our stock reflected in executive compensation through our equity incentive programs, including stock options and restricted stock awards.

### **Role of Executive Officers in Compensation Decisions**

The Compensation, Corporate Governance and Nominating Committee supervises the design and implementation of compensation policies for all executive officers (which include the named executive officers) and overall incentive equity awards to all employees of the Company. Decisions regarding the non-equity compensation of executive officers, other than named executive officers, are made by the Chief Executive Officer within the compensation philosophy set by the Committee. Decisions regarding the non-equity compensation of named executive officers are made by the Chief Executive Officer and the Committee for consistency with the Company's compensation policies.

The Chief Executive Officer semi-annually reviews the performance of each member of the senior executive team, including named executive officers (other than himself whose performance is reviewed by the Committee). The conclusions reached and recommendations based on these reviews, including with respect to salary adjustments and annual award amounts, are then presented to the Committee by the Chief Executive Officer. The Committee will review and approve the recommendations for consistency with the Company's compensation policies.

### **Setting Executive Compensation**

During the course of each fiscal year, it has been the practice of the Chief Executive Officer to review the history of all the elements of each executive officer's total compensation and the Chief Executive Officer may also compare the compensation of the executive officers with that of the executive officers in an appropriate market comparison group of companies with a capitalization similar to that of the Company. We seek to set compensation levels that are perceived as fair, internally and externally, and competitive with overall compensation levels at other companies in our industry, including larger companies from which we may want to recruit employees. However, the Company does not establish individual objectives in the range of comparative data for each individual or for each element of

compensation. Typically, the Chief Executive Officer sets compensation with respect to the executive officers who report to him and presents it to the Committee for conformity with the Company's overall compensation policies. The named executive officers are not present at the time of these deliberations. The Committee then performs a similar review of the Chief Executive Officer's total compensation and makes compensation decisions with respect to such officer, who does not participate in that determination.

We choose to pay each element of compensation in order to attract and retain the necessary executive talent, reward annual performance and provide incentive for balanced focus on long-term strategic goals as well as short-term performance. The amount of each element of compensation is determined by or under the direction of our Committee, which uses the following factors to determine the amount of salary and other benefits to pay each named executive officer:

performance against corporate and individual objectives for the year;



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difficulty of achieving desired results in the coming year;

value of their unique skills and capabilities to support long-term performance;

performance of their general management responsibilities; and

contribution as a member of the executive management team.

We do not establish individual goals but focus on the overall profitable growth of our business.

Based on the foregoing objectives, we have structured the Company's annual and long-term incentive-based cash and non-cash executive compensation to motivate executives to achieve the business goals set by the Company and reward the executives for achieving such goals.

There is no pre-established policy or target for the allocation between either cash or non-cash compensation. Historically we have granted a majority of total compensation to executive officers in the form of cash compensation.

For the year ended December 31, 2013, the principal components of compensation for named executive officers were:

base salary;

performance-based incentive compensation based on the Company's and the executive's performance; and

retirement and other benefits made available to all employees.

**Base Salary**

The Company provides named executive officers and other employees with base salary to compensate them for services rendered during the fiscal year. Executive base salaries continue to reflect our operating philosophy, our performance driven corporate culture and business direction, with each salary determined by the skills, experience and performance level of the individual executive, and the needs and resources of the Company. Base salaries are targeted to market levels based on reviews of published salary surveys and the closest related peer company compensation since we do not believe that Newtek has any peer companies. Base salary ranges for named executive officers are determined for each executive based on his or her position and responsibility by using market data from published salary surveys such as Equilar, and the Company generally attempts to fix each named executive officer's salary within the range. We believe that the Company's most direct competitors for executive talent are not necessarily restricted to those companies that are included in the peer company index used to compare shareholder returns, but encompass a broader group of companies engaged in the recruitment and retention of executive talent in competition with the Company.

During the review of base salaries for senior level executives, including the named executive officers, we primarily consider:

an internal review of each executive's compensation both individually and relative to other executive officers;

individual performance of the executive; and

a review of the Company's revenue growth, net income and cash flow metrics relative to the Company's annual plan as established by the Board.

Salary levels are typically considered annually as part of the Company's performance review process as well as upon a promotion or other change in job responsibility. Merit based increases to salaries are based on the Chief Executive Officer's assessment of the individual's performance. Merit based increases to the salaries of named executive officers other than the Chief Executive Officer are recommended by the Chief Executive Officer and confirmed by the Committee and those for the Chief Executive officer are determined by the Committee.

### **Annual Bonus**

Annual bonuses may be awarded to executive officers under the Company's cash bonus plan. The Company creates a bonus pool based on annually determined percentage of the salaries of all employees which it accrues as an expense. Payments under the plan are based on the Company's overall performance as determined by the Chief Executive Officer and the Committee. The Committee determines any bonus for the Chief Executive Officer based on, among other things, a review of the Company's revenue growth, net income and cash flow relative to the Company's annual plans as established by the Board. The Chief Executive Officer in consultation with the Committee with respect to the named executive officers, or in consultation with the named executive officers and other senior level officers with respect to lower level employees, determines annual bonuses for other employees based on such employee's performance. Factors considered include the achievement of business plans, defined goals and performance relative to other companies of a similar size and business strategy. The mix and weighting of the factors vary, depending on the business segment and the executive's responsibilities. The level of achievement and overall contribution by the executive determines the level of bonus.

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### **Equity-Based Compensation**

From time to time, at the discretion of the Committee, the Company grants equity-based awards, such as stock options or restricted stock to the named executive officers and other employees to create a clear and strong alignment between compensation and shareholder return and to enable the named executive officers and other employees to develop and maintain a stock ownership position in the company that will vest over time and act as an incentive for the employee to remain with the Company. Restricted stock and options may be granted pursuant to the Company's 2003 Stock Incentive Plan or its 2010 Stock Incentive Plan. The Company's 2000 Incentive Stock and Deferred Compensation Plan remains in existence but no additional option awards may be made under it since 2010 in accordance with its terms. During the Company's early years of operation, through approximately 2005, we relied more frequently than at present on equity-based awards due to the limited resources available to the Company to attract and retain qualified employees and executives. During that period the Company paid very little in the form of cash bonuses using instead equity-based awards. Currently, the cash flow of the Company, permits a more balanced approach, allowing a combination of cash and equity awards to implement the Company's compensation policies.

Under applicable accounting rules, we are required to measure the value of equity awards based on the fair value of the award on the grant date. The cost is recognized in our statement of operations over the period during which an employee is required to provide service in exchange for the award, which is usually the vesting period.

Options are awarded at the average of the highest and lowest sale price of the Company's Common Shares on the NASDAQ market on the date of the grant (the Market Value). In certain limited circumstances, the Committee may grant options to an executive at an exercise price in excess of the Market Value of the Company's Common Shares on the grant date. The Committee has never granted options with an exercise price that is less than the Market Value of the Company's common shares on the grant date, nor has it granted options which are priced on a date other than the grant date.

Options granted by the Committee typically vest over the first two to five years of the ten-year option term, although in certain cases we have granted options that have vested immediately. Vesting rights cease upon termination of employment and vested options granted prior to 2008 may be exercised within one year of termination (other than termination for cause) and those granted in 2008 and subsequent which have vested have 90 days after termination in which to exercise. Prior to the exercise of an option, the holder has no rights as a shareholder with respect to the shares subject to such option, including voting rights and the right to receive dividends or dividend equivalents.

Upon a change of control, or if earlier, the execution of an agreement to effect a change of control, all options and restricted stock awards under the Company's 2000 Incentive Stock and Deferred Compensation Plan, its 2003 Stock Incentive Plan and its 2010 Stock Incentive Plan become fully vested and immediately exercisable, notwithstanding any other provision of the plan or any agreement.

### **Benefits and Perquisites**

Our executives are generally not entitled to benefits that are not available to all of our employees. In this regard, it should be noted that we do not provide pension arrangements, post-retirement health coverage or similar benefits for our executives or employees. The Committee periodically reviews the levels of benefits provided to executive officers. The named executive officers participate in the Company's 401(k) savings plan and other benefit plans on the same basis as other similarly situated employees. The Company has adopted a match for the Company's 401(k) savings plan which consists of a discretionary match of 50% of the first 2% of employee contributions up to a maximum of 1% of the employee's compensation. At the Company's discretion the match may be in the form of cash or Company Common Shares. In 2013, a match of \$136,976 in Common Shares was approved and will be paid in March

2014.

The perquisites we provided in fiscal 2013 are as follows. We paid the premiums on life insurance policies for and certain travel costs for Mr. Sloane the Chief Executive Officer in the amount of \$4,385.

#### **Compensation of the Chief Executive Officer**

The Committee determined the compensation for Barry Sloane, Chairman, Chief Executive Officer and President for 2013. While recognizing the Chief Executive Officer's leadership in building a highly talented management team and in driving the Company forward, Mr. Sloane's salary was increased to \$400,000 in March 2013. Mr. Sloane earned a \$100,000 bonus for 2013 (to be paid in March 2014), a \$300,000 bonus earned in 2012 and paid in 2012 and a \$100,000 bonus earned in 2011 and paid in 2012. In addition Mr. Sloane received a grant of 75,000 Common Shares in 2013 which will vest in May 2016, and he received 400,000 Common Shares in 2011 which will vest in July 2014,

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with a value as of the date of award of \$139,500 and \$680,000, respectively. The Committee has determined that this salary and bonus package is competitive with the labor market median for someone with his skills and talents and is reflective of the Company's current cash and financial position and the status of the Company's Common Shares. Mr. Sloane's base compensation had previously remained unchanged from 2005 through 2012.

### **Compensation of the Other Named Executive Officers**

The Committee approved the 2013 compensation for Craig J. Brunet, Executive Vice President and Chief Information Officer, and Jennifer Eddelson, Executive Vice President and Chief Accounting Officer as recommended to it by the Chief Executive Officer.

Mr. Brunet's base salary was maintained at \$276,000 in 2013, 2012 and 2011. Mr. Brunet did not earn a bonus for 2013. In 2012 Mr. Brunet received an award of 10,000 Common Shares which will vest in May 2016, valued at \$18,600 and a cash bonus of \$41,400. In 2011, Mr. Brunet was awarded 50,000 Common Shares which will vest in July 2014 valued at \$85,000 and did not receive a cash bonus.

Ms. Eddelson's base salary for 2013 and 2012 was \$240,000 and \$230,833, respectively, and \$92,500 from July 1, 2011 through December 31, 2011. Ms. Eddelson received a \$50,000 cash bonus for 2013 (to be paid in March 2014). In 2012 Ms. Eddelson received a cash bonus of \$50,000 and an award of 10,000 Common Shares which will vest in May 2016 valued at \$18,600. In 2011, Ms. Eddelson received a cash bonus of \$35,000 which was paid in 2012, and an award of 35,000 Common Shares which vest in July 2014, valued at \$56,000.

The Chief Executive Officer and the Committee have determined that these compensation packages are competitive with the labor market median for managers with their skills and talents and are reflective of the Company's current cash and financial position and the status of the Company's Common Shares.

### **Conclusion**

Attracting and retaining talented and motivated management and employees is essential to creating long-term shareholder value. Offering a competitive, performance-based compensation program helps to achieve this objective by aligning the interests of the executive officers and other key employees with those of shareholders. We believe that the Company's 2013 compensation program met those objectives.

### **ADVISORY VOTE ON EXECUTIVE COMPENSATION**

At our 2011 annual meeting 98.94% of the votes cast on the advisory vote on executive compensation proposal were in favor of holding an advisory vote of shareholders on executive compensation, and 82.69% of the votes cast were in favor of holding that advisory vote every three (3) years. The Compensation, Corporate governance and Nominating Committee reviewed these results and determined that our shareholders should vote on a say-on-pay proposal every three years. Accordingly, the next say-on-pay vote will be at our 2014 annual meeting.

### **COMPENSATION RISK ASSESSMENT**

Our Compensation, Corporate Governance and Nominating Committee aims to establish company-wide compensation policies and practices that reward contributions to long-term shareholder value and do not promote unnecessary or excessive risk-taking. In furtherance of this objective, the Committee conducted an assessment of our compensation arrangements, including those for our named executive officers. The assessment process included, among other things, a review of our (1) compensation philosophy, (2) compensation mix and (3) cash and equity-based incentive plans.

In its review, among other factors, the Committee considered the following:

Our revenue model and our cash incentive plan encourage our employees to focus on creating a stable, predictable stream of revenue over multiple years, rather than focusing on current year revenue at the expense of succeeding years.

The distribution of compensation among our core compensation elements has effectively balanced short-term performance and long-term performance.

Our cash and equity-based incentive awards in conjunction with management efforts focus on both near-term and long-term goals.

Our cash and equity-based incentive awards contain a range of performance levels and payouts, to discourage executives from taking risky actions to meet a single target with an all or nothing result of compensation or no compensation.

Our executives are encouraged to hold a meaningful number of our Common Shares pursuant to our stock ownership policy.

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Based upon this assessment, our Compensation, Corporate Governance and Nominating Committee believes that our company-wide compensation policies and practices do not create risks that are reasonably likely to have a material adverse effect on us.

**COMPENSATION COMMITTEE REPORT**

The Compensation, Corporate Governance and Nominating Committee of the Company has reviewed and discussed the foregoing Compensation Discussion and Analysis for fiscal 2013 required by Item 402(b) of Regulation S-K with management and, based on such review and discussions, the Compensation, Corporate Governance and Nominating Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this Proxy Statement.

**THE COMPENSATION, CORPORATE GOVERNANCE AND NOMINATING COMMITTEE**

Salvatore F. Mulia, Chairman

David C. Beck

Sam Kirschner

**SUMMARY COMPENSATION TABLE**

The following tables set forth the aggregate compensation earned by the Company's Chief Executive Officer, Chief Investment Officer and Chief Accounting Officer, and next most highly compensated executive officers during 2013 and the two previous years which we refer to as named executive officers.

| Name and Principal Position                        | Year | Salary (\$)            | Bonus (\$)             | Stock Awards (\$) <sup>(4)</sup> | Option Awards (\$) <sup>(4)</sup> | Change in Pension Value All and other Non-Equity Incentive Compensation Deferred (in \$10,000) |      |      | Total (\$) |
|--|------|------------------------|------------------------|----------------------------------|-----------------------------------|--|------|------|------------|
|  |      |                        |                        |                                  |                                   | (\$)   | (\$) | (\$) |            |
| Barry Sloane, CEO                                  | 2013 | 391,667 <sup>(1)</sup> | 100,000 <sup>(9)</sup> |                                  |                                   |  |      |      | 491,667    |
|  | 2012 | 350,000                | 300,000 <sup>(3)</sup> | 139,500 <sup>(6)</sup>           |                                   |  |      |      | 788,750    |
|  | 2011 | 350,000                | 100,000 <sup>(2)</sup> | 680,000 <sup>(8)</sup>           |                                   |  |      |      | 1,130,000  |
| Craig J. Brunet, EVP and Chief Information Officer | 2013 | 276,000                |                        |                                  |                                   |  |      |      | 276,000    |
|  | 2012 | 276,000                | 41,400 <sup>(3)</sup>  | 18,600 <sup>(6)</sup>            |                                   |  |      |      | 335,900    |
|  | 2011 | 276,000                |                        | 85,000 <sup>(8)</sup>            |                                   |  |      |      | 361,000    |

|  |      |                       |                       |                       |         |
|--|------|-----------------------|-----------------------|-----------------------|---------|
| Jennifer Eddelson, EVP and Chief Accounting Officer <sup>(5)</sup> | 2013 | 240,000               | 50,000 <sup>(9)</sup> |                       | 290,000 |
|  | 2012 | 230,833               | 50,000 <sup>(3)</sup> | 74,600 <sup>(7)</sup> | 355,333 |
|  | 2011 | 92,500 <sup>(5)</sup> | 35,000 <sup>(2)</sup> | 25,500 <sup>(8)</sup> | 243,833 |

- (1) Mr. Sloane received an increase in base salary on March 1, 2013.
- (2) Cash bonus awarded for 2011 performance and paid in 2012.
- (3) Cash bonus awarded for 2012 performance and paid in 2012.
- (4) The value reported for Stock and Option Awards is the aggregate grant date fair value of options or stock awards granted to the named executive officers in the years shown, determined in accordance with FASB ASC Topic 718, disregarding adjustments for forfeiture assumptions. The assumptions for making the valuation determinations are set forth in the footnote titled "Stock-Based Compensation" to our financial statements in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013.
- (5) Effective July 1, 2011.
- (6) Stock grant awarded for 2012 performance, granted in 2013.
- (7) \$18,600 was for stock grants awarded for 2012 performance, granted in 2013; \$56,000 was for stock grants awarded for 2011 performance, granted in 2012.
- (8) Stock grant awarded for 2011 performance, granted in 2012.
- (9) Cash bonus awarded for 2013 performance to be paid in 2014.



**Table of Contents****Equity Compensation Plans**

The following table provides information as of December 31, 2013 with respect to our Common Shares that may be issued under our equity compensation plans.

| <b>Plan Category</b>  | <b>Number of Securities to be issued upon Exercise of Outstanding Options, Warrants and Rights</b> | <b>Weighted Average Exercise Price of Outstanding Options, Warrants and Rights<sup>(2)</sup></b> | <b>Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans</b> |
|---|--|--|---|
| Equity Compensation Plans Approved by Stockholders <sup>(1)</sup> | 2,094,970  | \$ 1.45  | 3,081,068   |
| Equity Compensation Plans Not Approved by Stockholders            |  |  |   |
| <b>Total</b>  | <b>2,094,970</b>   | <b>\$ 1.45</b>   | <b>3,081,068</b>  |

(1) Consists of 4,250,000 common shares under the Company's 2000 Stock Incentive and Deferred Compensation Plan, 1,000,000 common shares under the Company's 2003 Stock Incentive Plan, and 1,650,000 common shares under the Company's 2010 Stock Incentive Plan.

(2) Excludes 1,503,100 restricted stock rights which have a zero exercise price.

**GRANTS OF PLAN BASED AWARDS**

The following reflects all grants to our named executive officers awarded in the fiscal year ended December 31, 2013, all of which vest on March 1, 2016.

| <b>Name</b> | <b>Grant date</b> | <b>Estimated Future Payouts Under Non-Equity Incentive Plan Awards</b> |               |                | <b>Estimated Future Payouts Under Equity Incentive Plan Awards</b> |               |                | <b>All Other Stock Awards</b> | <b>All Exercise or Base Price</b> | <b>Grant Date Fair Value of</b> |
|-------------|-------------------|--|---------------|----------------|--|---------------|----------------|-------------------------------|-----------------------------------|---------------------------------|
|             |                   | <b>Threshold</b>   | <b>Target</b> | <b>Maximum</b> | <b>Threshold</b>   | <b>Target</b> | <b>Maximum</b> |                               |                                   |                                 |
|             |                   | (\$)   | (\$)          | (\$)           | (#)  | (#)           | (#)            |                               |                                   |                                 |

|                                       |            | <b>Number of Shares of Stock or Units</b> | <b>Number of Securities or Options (#)</b> | <b>Option Awards (\$/Sh)</b> | <b>Stock and Option Awards (\$)</b> |
|---------------------------------------|------------|---|--|------------------------------|-------------------------------------|
| <b>Barry Sloane, CEO</b>              | 01/15/2013 | 75,000                                    |  |                              | 139,500                             |
| <b>Craig J. Brunet, EVP, CIO</b>      | 01/15/2013 | 10,000                                    |  |                              | 18,600                              |
| <b>Jennifer C. Eddelson, EVP, CAO</b> | 01/15/2013 | 10,000                                    |  |                              | 18,600                              |

**OUTSTANDING EQUITY AWARDS AT 2013 YEAR END**

The following table reflects all outstanding equity awards held by our named executive officers as of December 31, 2013:

| Name                                      | Option Awards (1)   |   |   |                     |                        | Stock Awards   |  |   |   |
|---|---|---|---|---------------------|------------------------|--|--|---|---|
|   | Number of Securities Underlying Unexercised Options Exercisable (#) | Number of Securities Underlying Unexercised Options (#) | Number of Securities Underlying Unexercised Options (#) | Exercise Price (\$) | Option Expiration Date | Market Value of Shares or Units that have not vested (#) | Value of Shares or Units that have not vested (\$) | Equity Incentive Plan Awards: Number of Shares, Rights or Other | Equity Incentive Plan Awards: Market Payout Value of Unearned Shares, Units or Other Rights that have not vested (\$) |
| <b>Barry Sloane, CEO</b>                  |   |   |   |                     |                        |  |  | 75,000(2)<br>400,000(3)   | 139,500<br>680,000  |
| <b>Craig J. Brunet, EVP,<br/>CIO</b>      |   |   |   |                     |                        |  |  | 10,000(2)<br>50,000(3)  | 18,600<br>85,000  |
|   | 100,000 <sup>(1)</sup>  |   |   | 1.57                | 12/21/15               |  |  |   |   |
|   | 100,000 <sup>(1)</sup>  |   |   | 1.50                | 05/18/18               |  |  | 10,600(4)   | 13,250  |
| <b>Jennifer C. Eddelson,<br/>EVP, CAO</b> |   |   |   |                     |                        |  |  | 10,000(2)<br>35,000(3)  | 18,600<br>56,000  |
|   | 10,000 <sup>(1)</sup>   |   |   | 1.57                | 12/21/15               |  |  |   |   |
|   | 20,000 <sup>(1)</sup>   |   |   | 1.50                | 05/18/18               |  |  | 15,000(4)   | 25,500  |

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- (1) These options are fully vested.
- (2) These Common shares were awarded in 2013 and shall vest on the earliest of the following to occur: (a) March 1, 2016; (b) a Change in Control (as defined in the plan) of the Company; or (c) His/her death or total disability.
- (3) These Common shares were awarded in 2011 and shall vest on the earliest of the following to occur: (a) July 1, 2014; (b) a Change in Control (as defined in the plan) of the Company; or (c) His/her death or total disability.
- (4) These Common shares were awarded in 2010 and shall vest on the earliest of the following to occur: (a) July 1, 2014; (b) a Change in Control (as defined in the plan) of the Company; or (c) His/her death or total disability.

## **OPTIONS EXERCISED AND STOCK VESTED**

There were no stock options exercised nor restricted Common Shares vested during 2013 for the named executive officers.

## **Employment Agreements**

The Company has entered into separate employment agreements with the following three executive officers:

Barry Sloane, as Chairman, Chief Executive Officer and Secretary; and

Craig J. Brunet, as Executive Vice President and Chief Information Officer; and

Jennifer Eddelson, as Executive Vice President and Chief Accounting Officer

Barry Sloane, as Chairman and Chief Executive Officer, is responsible for implementing the policies adopted by the Company's Board of Directors.

Mr. Sloane's employment agreement provides for:

A twelve month term through March 31, 2015 at an annual base salary of \$400,000;

at least one annual salary review by the Board of Directors;

participation in any discretionary bonus plan established for senior executives;

retirement and medical plans, customary fringe benefits, vacation and sick leave; and

\$2 million of split-dollar life insurance coverage.

Mr. Brunet's employment agreement provides for:

A twelve month term through March 31, 2015 at an annual base salary of \$276,000;

at least one annual salary review by the Board of Directors;

participation in any discretionary bonus plan established for senior executives; and

retirement and medical plans, customary fringe benefits, vacation and sick leave.

Ms. Eddelson's employment agreement provides for:

A twelve month term through March 31, 2015 at an annual base salary of \$240,000;

at least one annual salary review by the Board of Directors;

participation in any discretionary bonus plan established for senior executives; and

retirement and medical plans, customary fringe benefits, vacation and sick leave.

#### **Payments upon Change of Control**

Mr. Sloane's employment agreement provides for a payment in the event of non-renewal of his employment in an amount equal to one and one half (1.5) times, or in the case of a change of control or termination other than for cause of the agreement an amount equal to two (2) times, the sum of (i) the executive's base salary in effect at the time of termination, plus (ii) the amount of any incentive compensation paid with respect to the immediately preceding fiscal year.

Mr. Brunet's and Ms. Eddelson's employment agreements provide for a payment in the case of termination other than for cause or in connection with a change in control of the agreement equal to one (1) times the sum of (i) the executive's base salary in effect at the time of termination, plus (ii) the amount of any incentive compensation paid with respect to the immediately preceding fiscal year. Mr. Brunet's employment agreement also provides for a payment in the case of non-renewal equal to one (1) times the sum of (i) the executive's base salary in effect at the time of termination, plus (ii) the amount of any incentive compensation paid with respect to the immediately preceding fiscal year.

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Each employment agreement contains a non-competition provision that requires the employee to devote substantially his full business time and efforts to the performance of the employee's duties under the agreement. The employee is not prohibited, however, from:

    serving on the boards of directors of, and holding offices or positions in, companies or organizations which, in the opinion of the Board of Directors, will not present conflicts of interest with the Company; or

    investing in any business dissimilar from the Company's or, solely as a passive or minority investor, in any business.

Under each of the employment agreements, the Company may terminate an employee's employment for just cause as defined in the agreement, and upon the termination, no severance benefits are available. If the employee voluntarily terminates his employment for good reason as defined in the agreement, or the employee's employment terminates during the term of the agreement due to death, disability, or retirement after age 62, the employee will be entitled to a continuation of his salary and benefits from the date of termination through the remaining term of the agreement. The employee is able to terminate voluntarily his agreement by providing 60 days written notice to the Board of Directors, in which case the employee is entitled to receive only his compensation, vested rights and benefits up to the date of termination.

**Table of Contents****Post Termination Payments**

The table below reflects the amount of compensation that would be payable to the executive officers under existing arrangements if the hypothetical termination of employment events described above had occurred on December 31, 2013, given their compensation and service levels as of such date. All payments are payable by the Company in a lump sum unless otherwise noted.

These benefits are in addition to benefits available regardless of the occurrence of such an event, such as currently exercisable stock options, and benefits generally available to salaried employees, such as distributions under the Company's 401(k) plan, disability benefits, and accrued vacation pay. In addition, in connection with any termination of Mr. Sloane's employment, the Company may determine to enter into an agreement or to establish an arrangement providing additional benefits or amounts, or altering the terms of benefits described below, as the Compensation, Corporate Governance and Nominating Committee deems appropriate.

The actual amounts that would be paid to our executive officers upon termination of employment can be determined only at the time of their separation from the Company.

| Name                        | Post Termination Payments |             |                              |
|-----------------------------|---------------------------|-------------|------------------------------|
|                             | Change<br>in Control      | Non-Renewal | Termination<br>without Cause |
| Barry Sloane, CEO           | \$ 1,079,000              | \$ 809,250  | \$ 1,079,000                 |
| Craig Brunet, EVP, CIO      | \$ 294,600                | \$ 294,600  | \$ 294,600                   |
| Jennifer Eddelson, EVP, CAO | \$ 258,600                | \$          | \$ 258,600                   |

**Nonqualified Deferred Compensation**

The Company did not have any nonqualified deferred compensation in the year ended December 31, 2013.

**Pension Benefits**

The Company had no obligation under pension benefit plans to the named executive officers as of December 31, 2013.

**Tax and Accounting Implications***Deductibility of Executive Compensation*

As part of its role, the Committee reviews and considers the deductibility of executive compensation under Section 162(m) of the Internal Revenue Code, which provides that the Company may not deduct compensation of more than \$1,000,000 that is paid to certain individuals. The Company believes that compensation paid by the Company is generally fully deductible for federal income tax purposes. However, in certain situations, the Committee may, in the future, approve compensation that will not meet these requirements in order to ensure competitive levels of total compensation for its executive officers.

*Accounting for Stock-Based Compensation*

Beginning on January 1, 2006, the Company began accounting for stock-based payments under its three incentive stock plans in accordance with the requirements of FASB Statement 123(R).

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The table below shows the number of our common shares beneficially owned as of March 26, 2014 by:

each person or group known by us to beneficially own more than 5% of our outstanding common shares;

each director and nominee for director;



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each executive officer named in the Summary Compensation Table under the heading Executive Compensation; and

all of our current directors and executive officers of the company as a group.

The number of shares beneficially owned by each 5% holder, director or executive officer is determined by the rules of the SEC, and the information does not necessarily indicate beneficial ownership for any other purpose. Under such rules, beneficial ownership includes any shares over which the person or entity has sole or shared voting power or investment power and also any shares that the person or entity can acquire within 60 days of February 14, 2014 through the exercise of any stock option or other right. For purposes of computing the percentage of outstanding shares of common shares held by each person or entity, any shares that the person or entity has the right to acquire within 60 days after February 14, 2014 are deemed to be outstanding with respect to such person or entity but are not deemed to be outstanding for the purpose of computing the percentage of ownership of any other person or entity. Unless otherwise indicated, each person or entity has sole investment and voting power (or shares such power with his or her spouse) over the shares set forth in the following table. The inclusion in the table below of any shares deemed beneficially owned does not constitute an admission of beneficial ownership of those shares. As of March 26, 2014, there were 35,438,668 Common Shares issued and outstanding.

| Name and Address of Beneficial Owner <sup>(1)</sup>                 | Shares Owned | Right to Acquire <sup>(2)</sup> | Total Beneficial Ownership <sup>(3)</sup> | Percent of Class |
|---|--------------|---------------------------------|---|------------------|
| David C. Beck   | 188,154      | 39,685                          | 227,839                                   | *                |
| Craig J. Brunet   | 86,734       | 200,000                         | 286,734                                   | *                |
| Jennifer C. Eddelson  | 13,370       | 30,000                          | 43,370                                    | *                |
| Sam Kirschner   | 79,303       |                                 | 79,303                                    | *                |
| Salvatore F. Mulia  | 86,625       |                                 | 86,625                                    | *                |
| Jeffrey G. Rubin <sup>(4)</sup>                                     | 4,291,505    |                                 | 4,291,505                                 | 12.11%           |
| Barry Sloane  | 4,727,464    |                                 | 4,727,464                                 | 13.34%           |
| All current directors and executive Officers as a group (7 persons) |              |                                 | 9,742,840                                 | 27.49%           |

\* Less than 1% of total common shares outstanding as of February 14, 2014

(1) Unless otherwise stated, the address of each person listed is c/o Newtek Business Services, Inc., 212 W. 35<sup>th</sup> Street, 2<sup>nd</sup> floor, New York, New York 10001.

(2) Number of shares underlying stock options which are exercisable as of February 14, 2014, or which become exercisable 60 days thereafter.

(3) As of February 14, 2014 except with respect to Mr. Rubin as of March 14, 2007.

(4) Resigned as President March 7, 2008.

**Table of Contents****ITEM 13. CERTAIN RELATIONSHIPS, RELATED PARTY TRANSACTIONS AND DIRECTOR INDEPENDENCE**

The Company may from time to time provide business services to executives of the Company or their family members. These transactions are conducted at arm's length and do not represent a material portion of the Company's revenues. In particular, the Board considered the compensation paid to Jeffrey G. Rubin and his related entities in connection with Mr. Rubin's business of acting as an independent service organization in the aggregation of electronic payment processing customers. That review determined that all transactions have been negotiated to be on a fully arm's length basis consistent with terms generally available in the market for similar transactions.

The Company's Code of Conduct provides that when any potential conflict exists, it must be properly disclosed and an appropriate determination made by the Company. The Chairman and CEO is ultimately responsible for the determination. The Company's policies and procedures were followed in connection with all of the above.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

McGladrey LLP and CohnReznick LLP served as the Company's independent registered public accounting firm for the years ended December 31, 2013 and December 31, 2012, respectively.

Fees for professional services rendered to the Company by McGladrey LLP during the fiscal year ended December 31, 2013 were as follows (in thousands):

|                    |            |
|--------------------|------------|
| Audit Fees         | \$ 570     |
| Audit Related Fees | 23         |
| All Other Fees     | 58         |
| <br>Total Fees     | <br>\$ 651 |

Fees for professional services rendered to the Company by CohnReznick LLP during the fiscal year ended December 31, 2012 were as follows (in thousands):

|                    |            |
|--------------------|------------|
| Audit Fees         | \$ 725     |
| Audit Related Fees | 60         |
| All Other Fees     |            |
| <br>Total Fees     | <br>\$ 785 |

*Audit Fees:* The audit fees for the fiscal years ended December 31, 2013 and 2012 were for professional services rendered in connection with the audits of the Company's annual financial statements, assistance with review of documents filed with the SEC, consents and other services required to be performed by our independent registered public accounting firm.

*Audit-Related Fees:* All other fees billed to the Company by McGladrey LLP and CohnReznick LLP during the fiscal years ended December 31, 2013 and 2012 for non-audit services and assurance and related services for attestations not required by law.

*Tax Fees:* No fees were billed to the Company by McGladrey LLP and CohnReznick LLP during the fiscal years ended December 31, 2013 and 2012 for professional services rendered in connection with tax compliance, tax advice, and tax planning.

*All Other Fees:* None.

In accordance with the Audit Committee Charter, all of the foregoing audit and non-audit fees paid to and the related services provided by McGladrey LLP and CohnReznick LLP were pre-approved by the Audit Committee.

**Table of Contents****PART IV****ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.**

(a)(1) Financial Statements.

(a)(2) Exhibits.

The following exhibits are filed herewith or are incorporated by reference to exhibits previously filed with the Securities and Exchange Commission.

| <b>Number</b> | <b>Description</b>   |
|---------------|--|
| 3.1           | Amended and Restated Certificate of Incorporation of Newtek Business Services, Inc., as amended (Incorporated by reference herein to Exhibit 3.1 to Newtek's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, filed August 12, 2010).                    |
| 3.2           | Bylaws of Newtek Business Services, Inc. (Incorporated by reference to Exhibit 3.2 to Newtek's Registration Statement on Form S-4, No. 333-115615, filed August 11, 2000).   |
| 10.1          | Employment Agreement with Barry Sloane, dated March 31, 2014.  |
| 10.2          | Employment Agreement with Craig J. Brunet, dated March 18, 2014.   |
| 10.3          | Employment Agreement with Jennifer C. Eddelson, dated March 17, 2014.  |
| 10.4          | Lease and Master Services Agreement dated March 15, 2007 between CrystalTech Web Hosting, Inc. and i/o Data Centers (Incorporated by reference to Exhibit 10.4 to Newtek's Quarterly Report on Form 10-Q for the quarter ended March 31, 2007, filed May 15, 2007).        |
| 10.5.1        | Loan and Security Agreement, dated as of April 30, 2010, between CrystalTech Web Hosting, Inc., Newtek Small Business Finance, Inc. and Capital One, N.A. (Incorporated by reference herein to Exhibit 10.16.1 to Newtek's Current Report on Form 8-K, filed May 4, 2010). |
| 10.5.2        | Guaranty of Payment and Performance, dated as of April 30, 2010, between Newtek Business Services, Inc. and Capital One Bank, N.A. (Incorporated by reference herein to Exhibit 10.16.2 to Newtek's Current Report on Form 8-K, filed May 4, 2010).                        |
| 10.6.1        | Newtek Business Services, Inc. 2010 Stock Incentive Plan (Incorporated by reference herein to Exhibit 10.17 to Newtek's Current Report on Form 8-K, filed June 14, 2010).  |
| 10.6.2        | Form of ISO Stock Option Agreement for Newtek's 2010 Stock Incentive Plan (Incorporated by reference herein to Exhibit 10.17.2 to Newtek's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, filed August 12, 2010).                                      |
| 10.6.3        | Form of Non-ISO Stock Option Agreement for Newtek's 2010 Stock Incentive Plan (Incorporated by reference herein to Exhibit 10.17.3 to Newtek's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, filed August 12, 2010).                                  |
| 10.6.4        | Form of Stock Appreciation Rights Agreement for Newtek's 2010 Stock Incentive Plan (Incorporated by reference herein to Exhibit 10.17.4 to Newtek's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, filed August 12, 2010).                             |

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- 10.6.5 Form of Restricted Share Award Agreement for Newtek's 2010 Stock Incentive Plan (Incorporated by reference herein to Exhibit 10.17.5 to Newtek's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, filed August 12, 2010.)
- 10.7.1 Loan and Security Agreement, dated as of December 15, 2010, between Newtek Small Business Finance, Inc. and Capital One Bank, N.A. (Incorporated by reference herein to Exhibit 10.18.1 to Newtek's Current Report on Form 8-K, filed December 20, 2010, as amended on March 2, 2011).
- 10.7.2 Guaranty Agreement, dated as of December 15, 2010, between Newtek Business Services, Inc. and Capital One Bank, N.A. (Incorporated by reference herein to Exhibit 10.18.2 to Newtek's Current Report on Form 8-K, filed December 20, 2010, as amended on March 2, 2011).
- 10.7.3 Amended and Restated Loan and Security Agreement, dated as of June 16, 2011, by and between Newtek Small Business Finance, Inc. and Capital One, N.A. (Incorporated by reference herein to Exhibit 10.8.3 to Newtek's Current Report on Form 8-K, filed June 21, 2011).

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|         |  |
|---------|--|
| 10.7.4  | Amended and Restated Guaranty of Payment and Performance, dated as of June 16, 2011, by and between Newtek Business Services, Inc., and Capital One, N.A. (Incorporated by reference herein to Exhibit 10.8.4 to Newtek's Current Report on Form 8-K, filed June 21, 2011).  |
| 10.7.5  | Amendment to Loan Documents, dated October 6, 2011, by and among Newtek Small Business Finance, Inc., Capital One Bank, N.A. and each of the guarantors listed on the signature pages thereto (Incorporated by reference herein to Exhibit 10.8.5 to Newtek's Current Report on Form 8-K, filed October 11, 2011). |
| 10.8.1  | Newtek Small Business Loan Trust Class A Notes, dated December 22, 2010 (Incorporated by reference herein to Exhibit 10.19.1 to Newtek's Current Report on Form 8-K, filed December 23, 2010).   |
| 10.8.2  | Amended Newtek Small Business Loan Trust Class A Notes, dated December 29, 2011 (Incorporated by reference herein to Exhibit 10.19.2 to Newtek's Current Report on Form 8-K, filed January 5, 2012).   |
| 10.8.3  | Additional Newtek Small Business Loan Trust Class A Notes, dated December 29, 2011 (Incorporated by reference herein to Exhibit 10.19.3 to Newtek's Current Report on Form 8-K, filed January 5, 2012).  |
| 10.9.1  | Loan and Security Agreement, dated as of February 28, 2011, by and between CDS Business Services, Inc. and Sterling National Bank (Incorporated by reference herein to Exhibit 10.10.1 to Newtek's Current Report on Form 8-K, filed March 3, 2011).   |
| 10.9.2  | Guaranty, dated as of February 28, 2011, by and between Newtek Business Services, Inc. and Sterling National Bank (Incorporated by reference herein to Exhibit 10.10.2 to Newtek's Current Report on Form 8-K, filed March 3, 2011).   |
| 10.9.3  | Amendment No. 1, dated December 5, 2012, to Loan and Security Agreement, dated as of February 28, 2011, by and between CDS Business Services, Inc. and Sterling National Bank (Incorporated by reference herein to Exhibit 10.9.3 to Newtek's Current Report on Form 8-K, filed December 11, 2012).                |
| 10.10.1 | Credit Agreement by and between Newtek Business Services, Inc. and Several Lenders dated as of April 25, 2012 (Incorporated by reference to Exhibit 10.10.1 to Newtek's Current Report on Form 8-K filed May 1, 2012).   |
| 10.10.2 | Warrant issued to Summit Partners Credit Advisers, L.P., dated April 25, 2012 (Incorporated by reference to Exhibit 10.10.1 to Newtek's Current Report on Form 8-K filed May 1, 2012).   |
| 21.1    | Subsidiaries of the Registrant filed herewith.   |
| 23.1    | Consent of McGladrey LLP filed herewith.   |
| 23.2    | Consent of CohnReznick LLP filed herewith.   |
| 31.1    | Certification by Principal Executive Officer required by Rule 13a-14(a) and 15d-14(a) under the Exchange Act, as amended filed herewith.   |
| 31.2    | Certification by Principal Financial Officer required by Rule 13a-14(a) and 15d-14(a) under the Exchange Act, as amended filed herewith.   |
| 32.1    | Certification by Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 filed herewith.  |
| 32.2    | Certification by Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 filed herewith.  |
| 101.SCH | XBRL Taxonomy Extension Schema Document  |

|         |  |
|---------|--|
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.LAB | XBRL Taxonomy Extension Labels Linkbase Document       |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

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Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**NEWTEK BUSINESS SERVICES, INC.**

Date: March 31, 2014

By: /s/ BARRY SLOANE  
**Barry Sloane**  
**Chairman and Chief Executive Officer**  
**(Principal Executive Officer)**

Date: March 31, 2014

By: /s/ JENNIFER EDDELSON  
**Jennifer Eddelson**  
**Chief Accounting Officer**  
**(Principal Financial Officer and Principal Accounting Officer)**

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <b>Signature</b>                                  | <b>Title</b>   | <b>Date</b>    |
|---|--|----------------|
| /s/ BARRY SLOANE<br><b>Barry Sloane</b>           | Chairman of the Board, President, Chief Executive Officer and Secretary<br><br>(Principal Executive Officer) | March 31, 2014 |
| /s/ JENNIFER EDDELSON<br><b>Jennifer Eddelson</b> | Chief Accounting Officer (Principal Financial Officer and Principal Accounting Officer)                      | March 31, 2014 |
| /s/ DAVID C. BECK<br><b>David C. Beck</b>         | Director   | March 31, 2014 |
| /s/ SALVATORE MULIA<br><b>Salvatore Mulia</b>     | Director   | March 31, 2014 |
| /s/ SAMUEL KIRSCHNER                              | Director   | March 31, 2014 |



**Samuel Kirschner**

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

**INDEX TO FINANCIAL STATEMENTS**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders

Newtek Business Services, Inc.

We have audited the accompanying consolidated balance sheet of Newtek Business Services, Inc. and Subsidiaries as of December 31, 2013, and the related statements of income, changes in stockholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated financial statements of Newtek Business Services, Inc. and Subsidiaries as of December 31, 2012, and for the years ended December 31, 2012 and 2011 were audited by other auditors and whose report, dated April 1, 2013, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2013 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Newtek Business Services, Inc. and Subsidiaries as of December 31, 2013, and the results of their operations and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

McGladrey LLP

New York, NY  
March 31, 2014

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of

Newtek Business Services, Inc.

We have audited the accompanying consolidated balance sheet of Newtek Business Services, Inc. and Subsidiaries as of December 31, 2012, and the related consolidated statements of income, changes in equity and cash flows for the years ended December 31, 2012 and 2011. Newtek Business Services, Inc. and Subsidiaries' management is responsible for these financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Newtek Business Services, Inc. and Subsidiaries as of December 31, 2012, and their results of operations and cash flows for the years ended December 31, 2012 and 2011, in conformity with accounting principles generally accepted in the United States of America.

/s/ CohnReznick LLP  
Jericho, New York  
April 1, 2013

Table of Contents**NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****FOR THE YEARS ENDED DECEMBER 31, 2013, 2012 AND 2011****(In Thousands, except for Per Share Data)**

|  | <b>2013</b>    | <b>2012</b>    | <b>2011</b>    |
|--|----------------|----------------|----------------|
| <b>Operating revenues:</b>   |                |                |                |
| Electronic payment processing  | \$ 89,651      | \$ 85,483      | \$ 82,473      |
| Web hosting and design   | 17,375         | 18,208         | 19,181         |
| Premium income   | 19,456         | 12,367         | 12,468         |
| Interest income  | 4,838          | 3,422          | 2,629          |
| Servicing fee income NSBF portfolio                                  | 2,769          | 2,298          | 1,635          |
| Servicing fee income external portfolios                             | 3,796          | 4,564          | 1,466          |
| Income from tax credits  | 113            | 522            | 1,390          |
| Insurance commissions  | 1,737          | 1,205          | 1,071          |
| Other income   | 3,858          | 3,061          | 3,026          |
| <b>Total operating revenues</b>                                      | <b>143,593</b> | <b>131,130</b> | <b>125,339</b> |
| <b>Net change in fair value of:</b>                                  |                |                |                |
| SBA loans  | (1,226)        | (1,013)        | (5,493)        |
| Warrants   |                | (111)          |                |
| Credits in lieu of cash and notes payable in credits in lieu of cash | 21             | 3              | (131)          |
| <b>Total net change in fair value</b>                                | <b>(1,205)</b> | <b>(1,121)</b> | <b>(5,624)</b> |
| <b>Operating expenses:</b>   |                |                |                |
| Electronic payment processing costs                                  | 75,761         | 72,183         | 69,389         |
| Salaries and benefits  | 24,360         | 22,314         | 21,042         |
| Interest   | 5,863          | 4,495          | 3,416          |
| Depreciation and amortization  | 3,284          | 3,036          | 3,955          |
| Provision for loan losses  | 1,322          | 810            | 763            |
| Lease restructuring charges  |                |                | 990            |
| Other general and administrative costs                               | 20,729         | 17,732         | 18,132         |
| <b>Total operating expenses</b>                                      | <b>131,319</b> | <b>120,570</b> | <b>117,687</b> |
| Income before income taxes   | 11,069         | 9,439          | 2,028          |
| Provision (benefit) for income taxes                                 | 3,918          | 3,882          | (1,195)        |

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|   |          |          |          |
|---|----------|----------|----------|
| Net income  | 7,151    | 5,557    | 3,223    |
| Net loss attributable to non-controlling interests        | 377      | 86       | 112      |
| Net income attributable to Newtek Business Services, Inc. | \$ 7,528 | \$ 5,643 | \$ 3,335 |
| Weighted average common shares outstanding:               |          |          |          |
| Basic   | 35,295   | 35,523   | 35,706   |
| Diluted   | 37,905   | 36,747   | 36,073   |
| Basic income per share                                    | \$ 0.21  | \$ 0.16  | \$ 0.09  |
| Diluted income per share                                  | \$ 0.20  | \$ 0.15  | \$ 0.09  |

See accompanying notes to these consolidated financial statements.

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**Table of Contents****NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****DECEMBER 31, 2013 AND 2012****(In Thousands, except for Per Share Data)**

|  | <b>2013</b>       | <b>2012</b>       |
|--|-------------------|-------------------|
| <b>ASSETS</b>  |                   |                   |
| Cash and cash equivalents  | \$ 12,508         | \$ 14,229         |
| Restricted cash  | 16,877            | 8,456             |
| Broker receivable  | 13,606            | 16,698            |
| SBA loans held for investment, net (includes \$10,894 and \$12,910, respectively related to securitization trust VIE; net of reserve for loan losses of \$1,811 and \$2,589, respectively) | 10,689            | 14,647            |
| SBA loans held for investment, at fair value (includes \$74,387 and \$22,931, respectively, related to securitization trust VIE)   | 78,951            | 43,055            |
| Accounts receivable (net of allowance of \$871 and \$561, respectively)  | 11,602            | 10,871            |
| SBA loans held for sale, at fair value   | 4,734             | 896               |
| Prepaid expenses and other assets, net (includes \$2,187 and \$1,123, respectively, related to securitization trust VIE)   | 18,549            | 11,014            |
| Servicing assets (net of accumulated amortization and allowances of \$7,909 and \$6,755, respectively)   | 6,776             | 4,682             |
| Fixed assets (net of accumulated depreciation and amortization of \$10,547 and \$10,885, respectively)   | 3,741             | 3,523             |
| Intangible assets (net of accumulated amortization of \$2,243 and \$5,591, respectively)   | 1,240             | 1,558             |
| Credits in lieu of cash  | 3,641             | 8,703             |
| Goodwill   | 12,092            | 12,092            |
| Deferred tax asset, net  | 3,606             | 2,318             |
| <b>Total assets</b>  | <b>\$ 198,612</b> | <b>\$ 152,742</b> |

**LIABILITIES AND EQUITY**

## Liabilities:

|  |                |               |
|--|----------------|---------------|
| Accounts payable, accrued expenses and other liabilities | \$ 14,688      | \$ 11,206     |
| Notes payable  | 41,218         | 39,823        |
| Note payable - Securitization trust VIE                  | 60,140         | 22,039        |
| Capital lease obligation                                 | 642            | 632           |
| Deferred revenue   | 1,274          | 1,437         |
| Notes payable in credits in lieu of cash                 | 3,641          | 8,703         |
| <b>Total liabilities</b>                                 | <b>121,603</b> | <b>83,840</b> |

Commitments and contingencies

## Equity:

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Newtek Business Services, Inc stockholders' equity:

|   |            |            |
|---|------------|------------|
| Preferred stock (par value \$0.02 per share; authorized 1,000 shares, no shares issued and outstanding)   |            |            |
| Common stock (par value \$0.02 per share; authorized 54,000 shares, 36,913 issued; 35,385 and 35,178 outstanding, respectively, not including 83 shares held in escrow) | 738        | 738        |
| Additional paid-in capital  | 61,349     | 60,609     |
| Retained earnings   | 14,536     | 7,008      |
| Treasury stock, at cost (1,528 and 1,735 shares, respectively)  | (1,279)    | (1,508)    |
| Total Newtek Business Services, Inc. stockholders' equity   | 75,344     | 66,847     |
| Non-controlling interests   | 1,665      | 2,055      |
| Total equity  | 77,009     | 68,902     |
| Total liabilities and equity  | \$ 198,612 | \$ 152,742 |

See accompanying notes to these consolidated financial statements.

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**NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2013, 2012 AND 2011**

(In Thousands)

|   | Number of<br>Shares of<br>Common<br>Stock | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Number<br>of<br>Shares<br>of<br>Treasury<br>Stock | Treasury<br>Stock | Non-<br>controlling<br>Interest | Total     |
|---|---|-----------------|----------------------------------|----------------------|---|-------------------|---------------------------------|-----------|
| Balance at December 31,<br>2010   | 36,701                                    | \$ 734          | \$ 57,650                        | \$ (3,436)           | 1,035   | \$ (663)          | \$ 1,309                        | \$ 55,594 |
| Issuance of treasury shares   |   |                 | 27                               |                      | (49)  | 59                |                                 | 86        |
| Purchase of treasury shares   |   |                 |                                  |                      | 13  | (16)              |                                 | (16)      |
| Grant of restricted stock<br>award  |   |                 | 479                              |                      |   |                   |                                 | 479       |
| Purchase of non-controlling<br>interest   |   |                 | (196)                            |                      |   |                   | (17)                            | (213)     |
| Net income  |   |                 |                                  | 3,335                |   |                   | (112)                           | 3,223     |
| Balance at December 31,<br>2011   | 36,701                                    | 734             | 57,960                           | (101)                | 999   | (620)             | 1,180                           | 59,153    |
| Cumulative-effect<br>adjustment, consolidation<br>of Expo                           |   |                 |                                  | 1,466                |   |                   | 2,290                           | 3,756     |
| Deconsolidation of<br>non-controlling interest for<br>Expo's interest in subsidiary |   |                 | (231)                            |                      |   |                   | (768)                           | (999)     |
| Expiration of subsidiary<br>non-controlling interest<br>warrants                    |   |                 | 337                              |                      |   |                   | (337)                           |           |
| Exercise of options   | 212                                       | 4               |                                  |                      |   |                   |                                 | 4         |
| Issuance of treasury shares   |   |                 | 25                               |                      | (67)  | 79                |                                 | 104       |
| Purchase of treasury shares   |   |                 |                                  |                      | 803   | (967)             |                                 | (967)     |
| Grant of restricted stock<br>award  |   |                 | 499                              |                      |   |                   |                                 | 499       |
| Issuance of warrant to<br>Summit  |   |                 | 2,070                            |                      |   |                   |                                 | 2,070     |
| Purchase of non-controlling<br>interest   |   |                 | (51)                             |                      |   |                   | (224)                           | (275)     |
| Net income  |   |                 |                                  | 5,643                |   |                   | (86)                            | 5,557     |

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|                                      |        |     |        |       |       |         |       |        |
|--------------------------------------|--------|-----|--------|-------|-------|---------|-------|--------|
| Balance at December 31, 2012         | 36,913 | 738 | 60,609 | 7,008 | 1,735 | (1,508) | 2,055 | 68,902 |
| Issuance of restricted stock         |        |     |        |       | (15)  |         |       |        |
| Grant of restricted stock awards     |        |     | 800    |       |       |         |       | 800    |
| Forfeitures of restricted stock      |        |     | (8)    |       |       |         |       | (8)    |
| Issuance of treasury shares          |        |     | 47     |       | (49)  | 59      |       | 106    |
| Exercise of stock options            |        |     | 33     |       | (143) | 170     |       | 203    |
| Purchase of non-controlling interest |        |     | (132)  |       |       |         | (13)  | (145)  |
| Net income                           |        |     |        | 7,528 |       |         | (377) | 7,151  |

|                              |        |        |           |           |       |            |          |           |
|------------------------------|--------|--------|-----------|-----------|-------|------------|----------|-----------|
| Balance at December 31, 2013 | 36,913 | \$ 738 | \$ 61,349 | \$ 14,536 | 1,528 | \$ (1,279) | \$ 1,665 | \$ 77,009 |
|------------------------------|--------|--------|-----------|-----------|-------|------------|----------|-----------|

See accompanying notes to these consolidated financial statements.

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**Table of Contents****NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED DECEMBER 31, 2013, 2012 AND 2011****(In Thousands)**

|   | <b>2013</b> | <b>2012</b> | <b>2011</b> |
|---|-------------|-------------|-------------|
| <b>Cash flows from operating activities:</b>  |             |             |             |
| Net income  | \$ 7,151    | \$ 5,557    | \$ 3,223    |
| Adjustments to reconcile net income to net cash provided by (used in) provided by operating activities: |             |             |             |
| Income from tax credits   | (113)       | (522)       | (1,390)     |
| Accretion of interest expense   | 135         | 525         | 1,259       |
| Fair value adjustments on SBA loans   | 1,226       | 1,013       | 5,493       |
| Fair value adjustment of credits in lieu of cash and notes payable in credits in lieu of cash           | (21)        | (3)         | 131         |
| Fair value adjustment on warrants   |             | 111         |             |
| Deferred income taxes   | (1,289)     | (2,245)     | (2,873)     |
| Depreciation and amortization   | 3,284       | 3,036       | 3,955       |
| Accretion of discount   | 515         | 247         |             |
| Provision for loan losses   | 1,322       | 810         | 763         |
| Lease restructuring charges   |             | (291)       | 990         |
| Other, net  | 1,929       | 946         | 394         |
| <b>Changes in operating assets and liabilities:</b>   |             |             |             |
| Originations of SBA loans held for sale   | (135,167)   | (83,349)    | (74,546)    |
| Originations of SBA loans transferred, subject to premium recourse                                      |             |             | (274)       |
| Proceeds from sale of SBA loans held for sale   | 131,733     | 84,743      | 73,871      |
| Proceeds from sale of SBA loans, achieving sale status  |             |             | 27,855      |
| Liability on SBA loans transferred, subject to premium recourse   |             |             | (30,783)    |
| Broker receivable   | 3,092       | (11,788)    | 7,148       |
| Accounts receivable   | (1,278)     | (2,766)     | (513)       |
| Prepaid expenses, accrued interest receivable and other assets  | (7,450)     | 3,245       | (3,093)     |
| Accounts payable, accrued expenses, other liabilities and deferred revenue                              | 3,717       | (597)       | 2,782       |
| Other, net  | (3,812)     | (3,026)     | (2,987)     |
| Net cash provided by (used in) operating activities   | 4,974       | (4,354)     | 11,405      |
| <b>Cash flows from investing activities:</b>  |             |             |             |
| Investments in qualified businesses   |             | (1,651)     |             |
| Returns of investments in qualified businesses  | 1,532       | 233         | 242         |
| Purchase of fixed assets and customer accounts  | (2,032)     | (3,055)     | (1,498)     |
| SBA loans originated for investment, net  | (42,885)    | (24,190)    | (22,269)    |
| Payments received on SBA loans  | 7,409       | 4,999       | 4,672       |

|                                       |          |          |          |
|---------------------------------------|----------|----------|----------|
| Change in restricted cash             |          | 1,441    | 1,239    |
| Purchase of non-controlling interest  | (145)    | (275)    | (196)    |
| Net cash used in investing activities | (36,121) | (22,498) | (17,810) |

See accompanying notes to these consolidated financial statements.

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**NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**  
**FOR THE YEARS ENDED DECEMBER 31, 2013, 2012 AND 2011**  
(In Thousands)

|  | 2013             | 2012             | 2011             |
|--|------------------|------------------|------------------|
| <b>Cash flows from financing activities:</b>   |                  |                  |                  |
| Net borrowings on bank lines of credit   | \$ 1,450         | \$ 18,387        | \$ 1,033         |
| Increase in cash due to consolidation of new subsidiary  |                  | 2,763            |                  |
| Proceeds from term loan  |                  | 10,000           |                  |
| Payments on bank term note payable   | (417)            | (417)            | (417)            |
| Payments on senior notes   | (7,522)          | (4,561)          | (2,821)          |
| Issuance of senior notes, net of issuance costs  | 45,343           |                  | 13,513           |
| Change in restricted cash due to debt refinancing  |                  |                  | (750)            |
| Change in restricted cash related to securitization  | (7,769)          | 5,053            | (2,954)          |
| Additions to deferred financing costs  | (1,867)          | (1,246)          |                  |
| Proceeds from exercise of stock options  | 198              |                  |                  |
| Purchase of treasury shares  |                  | (967)            | (16)             |
| Other, net   | 10               | 868              | (364)            |
| <b>Net cash provided by financing activities</b>   | <b>29,426</b>    | <b>29,880</b>    | <b>7,224</b>     |
| <b>Net (decrease) increase in cash and cash equivalents</b>  | <b>(1,721)</b>   | <b>3,028</b>     | <b>819</b>       |
| Cash and cash equivalents beginning of year  | 14,229           | 11,201           | 10,382           |
| <b>Cash and cash equivalents end of year</b>   | <b>\$ 12,508</b> | <b>\$ 14,229</b> | <b>\$ 11,201</b> |
| <b>Supplemental disclosure of cash flow activities:</b>  |                  |                  |                  |
| Cash paid for interest   | \$ 3,986         | \$ 2,844         | \$ 1,346         |
| Cash paid for taxes  | \$ 5,783         | \$ 5,402         | \$ 1,280         |
| <b>Non-cash investing and financing activities:</b>  |                  |                  |                  |
| Reduction of credits in lieu of cash and notes payable in credits in lieu of cash balances due to delivery of tax credits to Certified Investors | \$ 5,182         | \$ 9,362         | \$ 19,482        |
| Additional paid in capital, upon acquisition of subsidiaries non-controlling interests   | \$ 129           | \$               | \$               |
| Conversion of loans held for investment to other real estate owned   | \$ 625           | \$ 426           | \$ 241           |

|  |    |          |    |
|--|----|----------|----|
| Addition to assets and liabilities on January 1, 2012 as a result of consolidation of Exponential of New York, LLC |    |          |    |
| Assets   | \$ | \$ 2,763 | \$ |
| Liabilities  |    | 7        |    |
| Equity   | \$ | \$ 2,756 | \$ |
| Addition to additional paid-in capital for warrants expired previously attributable to non-controlling interests   |    |          |    |
|  | \$ | \$ 338   | \$ |
| Initial allocation of value issued to warrants issued in financing transaction                                     |    |          |    |
|  | \$ | \$ 1,959 | \$ |

See accompanying notes to these consolidated financial statements.

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION:**

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

The Company's principal business segments are:

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

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

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

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

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

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

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

*Non-controlling interests*

Non-controlling interests in results of operations of consolidated variable interest entities and majority-owned subsidiaries represents the non-controlling members' share of the earnings or loss of the consolidated variable interest entities and majority-owned subsidiaries. The non-controlling interest in the consolidated balance sheet reflects the original investment by these non-controlling members, along with their proportional share of earnings or losses.

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



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**Table of Contents****NOTE 2 SIGNIFICANT ACCOUNTING POLICIES:*****Use of Estimates***

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

During 2012, the Company revised its estimate for the amortization period of the servicing asset. Please see Note 5 to the Consolidated Financial Statements for a full discussion.

***Revenue Recognition***

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

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

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

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

progresses in its investments in Qualified Businesses and, accordingly, places an increasing proportion of the tax credits beyond recapture, it earns an amount equal to the non-recapturable tax credits and records such amount as income, with a corresponding asset called credits in lieu of cash in the balance sheet.

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

**Sales and Servicing of SBA Loans:** NSBF originates loans to customers under the SBA program that generally provides for SBA guarantees of 75% to 90% of each loan, subject to a maximum guarantee amount. This guaranteed portion is generally

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sold to a third party via an SBA regulated secondary market transaction utilizing SBA Form 1086 for a price equal to the guaranteed loan amount plus a premium. Prior to October 1, 2010, NSBF recognized the revenue item Premium on loan sales net of capitalized loan expenses and the discount on the retained unguaranteed portion; subsequent to the adoption of fair value of SBA 7(a) loans on October 1, 2010, NSBF recognizes premium on loan sales as equal to the cash premium plus the fair value of the initial servicing asset. Revenue is recognized on the trade date of the guaranteed portion.

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

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

**SBA Loan Interest and Fees:** Interest income on loans is recognized as earned. A loan is placed on non-accrual status if it exceeds 90 days past due with respect to principal or interest and, in the opinion of management, interest or principal on the loan is not collectible, or at such earlier time as management determines that the collectability of such principal or interest is unlikely. Such loans are designated as impaired non-accrual loans. All other loans are defined as performing loans. When a loan is designated as impaired non-accrual, the accrual of interest is discontinued, and any accrued but uncollected interest income is reversed and charged against current operations. While a loan is classified as impaired non-accrual and the future collectability of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding.

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

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

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

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

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

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

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

### ***Electronic Payment Processing Costs***

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

### ***Cash and Cash Equivalents***

The Company considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents. Invested cash is held almost exclusively at financial institutions with ratings from S&P of A- or better. The Company invests cash not held in interest free checking accounts or bank money market accounts mainly in U.S. Treasury only money market instruments or funds and other investment-grade securities. As of December 31, 2013, cash deposits in excess of FDIC deposit insurance and SIPC insurance totaled approximately \$10,802,000 and funds held in U.S. Treasury only money market funds or equivalents in excess of SIPC insurance totaled approximately \$44,000.

### ***Restricted Cash***

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

segment:

| <b>(In thousands):</b>        | <b>2013</b> | <b>2012</b> |
|-------------------------------|-------------|-------------|
| Electronic payment processing | \$ 573      | \$ 387      |
| Small business finance        | 12,829      | 4,955       |
| All other                     | 2,475       | 279         |
| Corporate activities          | 989         | 986         |
| Capcos                        | 11          | 1,849       |
| Totals                        | \$ 16,877   | \$ 8,456    |

***Broker Receivable***

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

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### ***Purchased Receivables***

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

### ***Allowance for Doubtful Accounts Purchased Receivables***

The allowance for doubtful accounts, related to purchased receivables, is established by management through provisions for bad debts charged against income. Amounts deemed to be uncollectible are charged against the allowance for doubtful accounts and subsequent recoveries, if any, are credited to income.

The amount of the allowance for doubtful accounts is inherently subjective, as it requires making material estimates which may vary from actual results. Management's ongoing estimates of the allowance for doubtful accounts are particularly affected by the performance of the client in their ability to provide the Company with future receivables coupled with the collections of their current receivables.

The allowance consists of specific and general components. The specific component relates to clients' aggregate net balance that is classified as doubtful. The general component covers non-classified balances and is based on historical loss experience.

A clients' aggregate net balance is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the receivable payments or the Company has greatly reduced the amount of receivables to be purchased.

The Company's charge-off policy is based on a client-by-client review for which the estimated uncollectible portion is charged off against the corresponding client's net balance and the allowance for doubtful accounts.

### ***Investments in Qualified Businesses***

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

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

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

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



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

***SBA Loans Held for Investment***

For loans that completed funding before October 1, 2010, SBA loans held for investment are reported at their outstanding unpaid principal balances adjusted for charge-offs, net deferred loan origination costs and the allowance for loan losses. For loans that completed funding on or after October 1, 2010, management elected to fair value SBA loans held for investment within the fair value hierarchy that prioritizes observable and unobservable inputs utilizing Level 3 unobservable inputs which reflect the Company's own expectations about the assumptions that market participants would use in pricing the asset (including assumptions about risk). Prior to 2013, the Company determined fair value based on its securitization pricing, as well as internal quantitative data on the portfolio with respect to historical default rates and future expected losses, and now uses a discounted cash flow method, which includes assumptions for cumulative default rates, prepayment speeds, servicing cost and a market yield.

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

***Allowance for SBA Loan Losses***

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

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

consolidated statement of operations.

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

Impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's market interest rate, or the fair value of the collateral less estimated costs to sell, if the loan is collateral dependent. Impaired loans for which the carrying amount is based on fair value of the underlying collateral are included in assets and reported at estimated fair value on a non-recurring basis, both at initial recognition of impairment and on an on-going basis until recovery or charge-off of the loan amount. The determination of impairment involves management's judgment in the use of market data and third

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party estimates regarding collateral values. For loans funded before October 1, 2010, the impairment of a loan resulted in management establishing an allowance for loan losses through provisions for loan losses charged against income; for subsequent loans at fair value, impairment results in a net change in the fair value of SBA loans held for investment. Amounts deemed to be uncollectible are charged against the allowance for loan losses or reduces the fair value and subsequent recoveries, if any, are credited to the allowance or increases the fair value.

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

***Troubled Debt Restructured Loans***

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

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

***SBA Loans Held For Sale***

For guaranteed portions funded, but not yet traded at each measurement date, management elected to fair value SBA loans held for sale within the fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value utilizing Level 2 assets. These inputs include debt securities with quoted prices that are traded less frequently than exchange-traded instruments or have values determined using a pricing model with inputs that are observable in the market. The secondary market for the guaranteed portions is extremely robust with broker dealers acting as primary dealers. NSBF sells regularly into the market and can quickly price its loans held for sale. The Company values the guaranteed portion based on observable market prices for similar assets.

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

***Fixed Assets***

Fixed assets, which are comprised of furniture and fixtures and computer office equipment, building and improvements, are stated at cost less accumulated depreciation and amortization. Depreciation of fixed assets is provided on a straight-line basis using estimated useful lives of the related assets. Amortization of leasehold improvements is provided on a straight-line basis using the lesser of the useful life of the asset or lease term. Useful lives of assets are: computer software, website development, and servers and storage (three years), computer and office equipment and furniture and fixtures (generally three to five years).

***Software and Website Development Costs***

The Company capitalizes its website development costs, online application system, referral system and other proprietary systems and computer software. Costs incurred during the preliminary project stage are expensed as incurred, while application stage projects are capitalized. The latter costs are typically employee and/or consulting services directly associated with the development of the internal use computer software. Software and website costs are included in fixed assets in the accompanying consolidated balance sheets. Amortization commences once the software is ready for its intended use and is amortized using the straight-line method over the estimated useful life, typically three years.

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### ***Deferred Financing Costs***

Deferred financing costs are being amortized under the straight-line method over the terms of the related indebtedness, which approximates the effective interest method and is included in interest expense in the accompanying consolidated statements of income.

### ***Impairment of Long-Lived Assets***

Long-lived assets, including fixed assets and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. In reviewing for impairment, the carrying value of such assets is compared to the estimated undiscounted future cash flows expected from the use of the assets and their eventual disposition. If such cash flows are not sufficient to support the asset's recorded value, an impairment charge is recognized to reduce the carrying value of the long-lived asset to its estimated fair value. The determination of future cash flows as well as the estimated fair value of long-lived assets involves significant estimates on the part of management. In order to estimate the fair value of a long-lived asset, the Company may engage a third party to assist with the valuation. If there is a material change in economic conditions or other circumstances influencing the estimate of future cash flows or fair value, the Company could be required to recognize impairment charges in the future.

### ***Securitization Activities***

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

### ***Goodwill and Other Intangible Assets***

Goodwill and other intangible assets deemed to have an indefinite life are not amortized and are subject to impairment tests, at least annually. Other intangible assets with finite lives are amortized over their useful lives ranging from 18 to 66 months, and evaluated as discussed in Note 10.

The Company considers the following to be some examples of indicators that may trigger an impairment review outside its annual impairment review: (i) significant under-performance or loss of key contracts acquired in an acquisition relative to expected historical or projected future operating results; (ii) significant changes in the manner or use of the acquired assets or in the Company's overall strategy with respect to the manner or use of the acquired assets or changes in the Company's overall business strategy; (iii) significant negative industry or economic trends; (iv) increased competitive pressures; (v) a significant decline in the Company's stock price for a sustained period of time; and (vi) regulatory changes. In assessing the recoverability of the Company's goodwill and intangibles, the Company must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. These include estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for the Company, the useful life over which cash flows will occur, and determination of the Company's cost of capital. Changes in these estimates and assumptions could materially affect the determination of fair value and conclusions on goodwill impairment.

### ***Reserve for Losses on Merchant Accounts***

Disputes between a cardholder and a merchant periodically arise as a result of, among other things, cardholder dissatisfaction with merchandise quality or merchant services. Such disputes may not be resolved in the merchant's favor. In these cases, the transaction is charged back to the merchant, which means the purchase price is refunded to the customer through the merchant's acquiring bank and charged to the merchant. If the merchant has inadequate funds, the Company or, under limited circumstances, the Company and the acquiring bank, must bear the credit risk for the full amount of the transaction. The Company evaluates its risk for such transactions and estimates its potential loss for charge-backs based primarily on historical experience and other relevant factors.

The Company records reserves for charge-backs and contingent liabilities when such amounts are deemed to be probable and estimable. The required reserves may change in the future due to new developments, including, but not limited to, changes in litigation or increased charge-back exposure as the result of merchant insolvency, liquidation, or other reasons. The required reserves are reviewed periodically to determine if adjustments are required.

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**Table of Contents*****Share Based Compensation***

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

***Fair Value***

The Company adopted the methods of fair value to value its financial assets and liabilities. The Company carries its credits in lieu of cash, prepaid insurance and notes payable in credits in lieu of cash at fair value. The Company also carries impaired loans and other real estate owned at fair value. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, the Company utilized a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

- Level 1** Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain U.S. Government and agency mortgage-backed debt securities, corporate debt securities, derivative contracts and residential mortgage loans held-for-sale.
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly structured or long-term derivative contracts.

***Income Taxes***

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

The Company's U.S. Federal and state income tax returns prior to fiscal year 2009 are closed, and management continually evaluates expiring statutes of limitations, audits, proposed settlements, changes in tax law and new authoritative rulings.

*Accounting for Uncertainty in Income Taxes*

The ultimate deductibility of positions taken or expected to be taken on tax returns is often uncertain. In order to recognize the benefits associated with a tax position taken (i.e., generally a deduction on a corporation's tax return), the entity must conclude that the ultimate allowability of the deduction is more likely than not. If the ultimate allowability of the tax position exceeds 50% (i.e., it is more likely than not), the benefit associated with the position is recognized at the largest dollar amount that has more than a 50% likelihood of being realized upon ultimate settlement.

Differences between tax positions taken in a tax return and recognized will generally result in (1) an increase in income taxes currently payable or a reduction in an income tax refund receivable or (2) an increase in a deferred tax liability or a decrease in a deferred tax asset, or both (1) and (2).



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**Table of Contents*****Fair Value of Financial Instruments***

As required by ASU Topic 825, Financial Instruments, the estimated fair values of financial instruments must be disclosed. Excluding fixed assets, intangible assets, goodwill, and prepaid expenses and other assets (excluding as noted below), substantially all of the Company's assets and liabilities are considered financial instruments as defined under this standard. Fair value estimates are subjective in nature and are dependent on a number of significant assumptions associated with each instrument or group of similar instruments, including estimates of discount rates, risks associated with specific financial instruments, estimates of future cash flows and relevant available market information.

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

Cash and cash equivalents

Restricted cash

Broker receivable

Accounts receivable

Notes payable

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

Accrued interest payable (included in accounts payable and accrued expenses)

Accounts payable and accrued expenses

The carrying value of investments in Qualified Businesses (included in prepaid expenses and other assets), Credits in lieu of cash and Notes payable in credits in lieu of cash as well as SBA loans held for investment, SBA loans held for sale, SBA loans transferred, subject to premium recourse and Liability on SBA loans transferred, subject to premium recourse (for loans funded after September 30, 2010) approximate fair value based on management's estimates.

***New Accounting Standards***

In July 2013, the FASB issued ASU No. 2013-11: Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (ASU 2013-11). The amendments in ASU 2013-11 are intended to end inconsistent practices regarding the presentation of unrecognized tax benefits on the balance sheet. An entity will be required to present an unrecognized tax benefit as a reduction of a

deferred tax asset for a net operating loss ( NOL ) or tax credit carryforward whenever the NOL or tax credit carryforward would be available to reduce the additional taxable income or tax due if the tax position is disallowed. This standard became effective for annual reporting periods beginning after December 15, 2013, and did not have a material impact on the Company's Consolidated Financial Statements or disclosures.

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

### ***Reclassifications***

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

### **NOTE 3 FAIR VALUE MEASUREMENTS:**

#### **Fair Value Option Elections**

Effective January 1, 2008, the Company adopted fair value accounting concurrent with the election of the fair value option. The accounting standard relating to the fair value measurements clarifies the definition of fair value and describes methods available to appropriately measure fair value in accordance with GAAP. The accounting standard applies whenever other accounting standards require or permit fair value measurements. The accounting standard relating to the fair value option for financial assets and financial liabilities allows entities to irrevocably elect fair value as the initial and subsequent

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measurement attribute for certain financial assets and financial liabilities that are not otherwise required to be measured at fair value, with changes in fair value recognized in earnings as they occur. It also establishes presentation and disclosure requirements designed to improve comparability between entities that elect different measurement attributes for similar assets and liabilities.

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

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

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

**Assets and Liabilities Measured at Fair Value on a Recurring Basis (In thousands):**

| (In thousands):                          | Fair Value Measurements at December 31, 2013 |           |                 |                  | Total Gains<br>and (Losses) |
|--|--|-----------|-----------------|------------------|-----------------------------|
|  | Total  | Level 1   | Level 2         | Level 3          |                             |
| <b>Assets</b>                            |  |           |                 |                  |                             |
| Credits in lieu of cash                  | \$ 3,641                                     | \$        | \$ 3,641        | \$               | \$                          |
| SBA loans held for investment            | 78,951                                       |           |                 | 78,951           | (1,629)                     |
| SBA loans held for sale                  | 4,734  |           | 4,734           |                  | 403                         |
| <b>Total assets</b>                      | <b>\$ 87,326</b>                             | <b>\$</b> | <b>\$ 8,375</b> | <b>\$ 78,951</b> | <b>\$ (1,226)</b>           |
| <b>Liabilities</b>                       |  |           |                 |                  |                             |
| Notes payable in credits in lieu of cash | \$ 3,641                                     | \$        | \$ 3,641        | \$               | \$ 21                       |
| <b>Total liabilities</b>                 | <b>\$ 3,641</b>                              | <b>\$</b> | <b>\$ 3,641</b> | <b>\$</b>        | <b>\$ 21</b>                |

**Table of Contents****Assets and Liabilities Measured at Fair Value on a Recurring Basis (In thousands):**

| <b>(In thousands):</b>                   | <b>Fair Value Measurements at December 31, 2012</b> |                |                 |                  | <b>Total Gains and (Losses)</b> |
|--|---|----------------|-----------------|------------------|---------------------------------|
|  | <b>Total</b>  | <b>Level 1</b> | <b>Level 2</b>  | <b>Level 3</b>   |                                 |
| <b>Assets</b>                            |   |                |                 |                  |                                 |
| Credits in lieu of cash                  | \$ 8,703  | \$             | \$ 8,703        | \$               | \$                              |
| SBA loans held for investment            | 43,055  |                |                 | 43,055           | (851)                           |
| SBA loans held for sale                  | 896   |                | 896             |                  | (162)                           |
| <b>Total assets</b>                      | <b>\$ 52,654</b>                                    | <b>\$</b>      | <b>\$ 9,599</b> | <b>\$ 43,055</b> | <b>\$ (1,013)</b>               |
| <b>Liabilities</b>                       |   |                |                 |                  |                                 |
| Notes payable in credits in lieu of cash | \$ 8,703  | \$             | \$ 8,703        | \$               | \$ 3                            |
| Warrants                                 |   |                |                 |                  | (111)                           |
| <b>Total liabilities</b>                 | <b>\$ 8,703</b>                                     | <b>\$</b>      | <b>\$ 8,703</b> | <b>\$</b>        | <b>\$ (108)</b>                 |

**Credits in Lieu of Cash, Prepaid Insurance and Notes Payable in Credits in Lieu of Cash**

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

Under the cost basis of accounting, the discount rates used to calculate the present value of the credits in lieu of cash and notes payable in credits in lieu of cash did not reflect the credit enhancements that the Company's Capcos obtained from Chartis, Inc. (Chartis) (the renamed property and casualty holdings of American International Group, Inc., AIG), namely its AA+ rating at such time, for their debt issued to certified investors. Instead the cost paid for the credit enhancements was recorded as prepaid insurance and amortized on a straight-line basis over the term of the credit enhancements.

With the adoption of the fair value measurement of financial assets and financial liabilities and the election of the fair value option, credits in lieu of cash and notes payable in credits in lieu of cash are valued based on the yields at which financial instruments would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. The accounting standards require the fair value of the assets or liabilities to be determined based on the assumptions that market participants use in pricing the financial instrument. In developing those assumptions, the Company identified characteristics that distinguish market participants generally, and considered factors specific to (a) the asset type, (b) the principal (or most advantageous) market for the asset group, and (c) market participants with whom the reporting entity would transact in that market.

Based on the aforementioned characteristics and in view of the Chartis credit enhancements, the Company believes that market participants purchasing or selling its Capcos debt and, therefore, its credits in lieu of cash and notes payable in credits in lieu of cash, view nonperformance risk to be equal to the risk of Chartis nonperformance risk and as such both the fair value of credits in lieu of cash and notes payable in credits in lieu of cash should be priced to yield a rate equal to comparable U.S. Dollar denominated debt instruments issued by Chartis parent, AIG. Because the value of notes payable in credits in lieu of cash directly reflects the credit enhancement obtained from Chartis, the unamortized cost relating to the credit enhancement will cease to be separately carried as an asset on the Company's consolidated balance sheets and is incorporated in notes payable in credits in lieu of cash.

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**Table of Contents****Fair value measurements:**

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

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

On December 31, 2012, the yield on the Chartis Note Basket was 1.72%. As of December 31, 2013, the date the Company revalued the asset and liability, the yields on the Chartis notes averaged 1.49% reflecting changes in interest rates in the marketplace. This decrease in yield increased both the fair value of the credits in lieu of cash and the fair value of the notes payable in credits in lieu of cash. The Company decreased the value of the credits in lieu of cash to equal the value of the notes payable in credits in lieu of cash because the credits in lieu of cash can only be used to satisfy the liability and must equal the value of the notes payable in credits in lieu of cash at all times. The net change in fair value reported in the Company's consolidated statements of income for the year ended December 31, 2013 was a gain of \$21,000.

On December 31, 2011, the yield on the Chartis Note Basket was 5.53%. As of December 31, 2012, the date the Company revalued the asset and liability, the yields on the Chartis notes averaged 1.72% reflecting changes in interest rates in the marketplace. This decrease in yield increased both the fair value of the credits in lieu of cash and the fair value of the notes payable in credits in lieu of cash. The Company decreased the value of the credits in lieu of cash to equal the value of the notes payable in credits in lieu of cash because the credits in lieu of cash can only be used to satisfy the liability and must equal the value of the notes payable in credits in lieu of cash at all times. The net change in fair value reported in the Company's consolidated statements of income for the year ended December 31, 2012 was a gain of \$3,000.

Changes in the future yield of the Chartis issued debt selected for valuation purposes will result in changes to the fair values of the credits in lieu of cash and notes payable in credits in lieu of cash when calculated for future periods; these changes will be reported through the Company's consolidated statements of income.

**SBA 7(a) Loans**

On October 1, 2010, the Company elected to utilize the fair value option for SBA 7(a) loans funded on or after that date. Management believed that doing so would promote its effort to both simplify and make more transparent its financial statements by better portraying the true economic value of this asset on its balance sheet and statement of income. NSBF originates, funds, and services government guaranteed loans under section 7(a) of the Small Business

Act. The SBA does not fully guarantee the SBA 7(a) Loans: An SBA 7(a) Loan is bifurcated into a guaranteed portion and an unguaranteed portion, each accruing interest on the principal balance of such portion at a per annum rate in effect from time to time. NSBF originates variable interest loans, usually set at a fixed index to the Prime rate that resets quarterly. Primarily, NSBF has made SBA 7(a) loans carrying guarantees of 75% and 85%; from 2009 through early 2011 under a special program, most of the loans NSBF originated carried a guarantee of 90%. NSBF, both historically and as a matter of its business plan, sells the guaranteed portions via SBA Form 1086 into the secondary market when the guaranteed portion becomes available for sale upon the closing and fully funding of the SBA 7(a) loan and retains the unguaranteed portions. Management recognized that the economic value in the guaranteed portion did not inure to NSBF at the time of their sale but rather when the guaranty attached at origination; amortization accounting by its nature does not recognize this increase in value at the true time when it occurred. Under fair value, the value of the guarantee is recorded when it economically occurs at the point of the creation and funding of the loan, and is not delayed until the sale occurs. Contemporaneously, the value of the unguaranteed portion will also be determined to reflect the full, fair value of the loan.

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

***SBA Loans Held for Investment***

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

In determining the net change in fair value of loans held for investment for the year ended December 31, 2013, the Company used a discounted cash flow model which incorporated a series of expected future cash flows for the performing SBA 7(a) loan portfolio, and discounts those cash flows at a market clearing yield of 5.38%. The key assumptions used in the model are considered unobservable inputs and include anticipated prepayment speeds, cumulative default rates, the cost of loan servicing, and Prime rate expectations. The Company used an assumed prepayment speed of 10% based on current market conditions and historical experience for the loan portfolio, against a prepayment curve developed from NSBF historical experience to calculate expected loan prepayments in a given year. Defaults are defined as any loan placed on non-accrual status as of December 31, 2013. The default rate, defined as the percent of loan balance that will enter final liquidation in a given year, was estimated to be 25%, and was derived from NSBF historical experience. The mix of NSBF's loan portfolio continues to shift from start-up businesses, to predominately originating to existing businesses. Our historical default and loss rates demonstrate that this particular segment (i.e. Existing Business) of our SBA loan portfolio continues to experience the lowest rate of defaults and ultimate losses over our nine year history of originating loans. When computing the cumulative default rate to be applied to the performing portfolio loan balances, the Company excluded the last three years of originations as those loans have not seasoned yet. The discounted cash flow resulted in a price equivalent of 93.99% of the par amount on our loans held for investment.

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

Below is a summary of the activity in SBA loans held for investment, at fair value (in thousands):

|                            | <b>December 31, 2013</b> | <b>December 31, 2012</b> |
|----------------------------|--------------------------|--------------------------|
| Balance, beginning of year | \$ 43,055                | \$ 21,857                |
|                            | 42,773                   | 24,076                   |



SBA loans held for investment,  
 originated

|   |           |           |
|---|-----------|-----------|
| Loans transferred to other real estate<br>owned | (362)     |           |
| Payments received                               | (4,886)   | (2,027)   |
| Fair value loss                                 | (1,629)   | (851)     |
| Balance, end of year                            | \$ 78,951 | \$ 43,055 |

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**Table of Contents****SBA Loans Held For Sale**

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

**Other Fair Value Measurements**

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

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

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

| <b>Fair Value Measurements at December 31, 2012 Using:</b> |              |                |                |                |                     |
|--|--------------|----------------|----------------|----------------|---------------------|
|  | <b>Total</b> | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total Losses</b> |
| <b>Assets</b>  |              |                |                |                |                     |
| Impaired loans   | \$ 6,965     | \$             | \$             | \$ 6,965       | \$ (810)            |
| Other real-estate owned                                    | 534          |                | 534            |                | (168)               |
| Total assets   | \$ 7,499     | \$             | \$ 534         | \$ 6,965       | \$ (978)            |

**Impaired loans**

Impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's market interest rate, or the fair value of the collateral if the loan is collateral dependent. Impaired loans for which the carrying amount is based on fair value of the underlying collateral less estimated costs to sell, are included in assets

and such fair value estimates are performed on a non-recurring basis, both at initial recognition of impairment and on an on-going basis until recovery or charge-off of the loan amount. The significant unobservable inputs used in the fair value measurement of the impaired loans involve management's judgment in the use of market data and third party estimates regarding collateral values. Such estimates are further discounted by 20% - 80% to reflect the cost of liquidating the various assets under collateral. Valuations in the level of impaired loans and corresponding impairment affect the level of the reserve for loan losses. Any subsequent increases or decreases in any of the inputs would result in a corresponding decrease or increase in the reserve for loan loss or fair value of SBA loans, depending on whether the loan was originated prior or subsequent to October 1, 2010.

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**Table of Contents****Other real-estate owned (included in Prepaid expenses and other assets)**

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

**NOTE 4 CREDITS IN LIEU OF CASH:**

As discussed in Note 3, the Company adopted fair value option for financial assets and financial liabilities concurrent with its adoption of fair value accounting for certain of its assets and liabilities. Following is a summary of the credits in lieu of cash balance as of December 31, 2013 and 2012 (in thousands):

|   | <b>2013</b>     | <b>2012</b>     |
|---|-----------------|-----------------|
| Balance, beginning of year                            | \$ 8,703        | \$ 16,948       |
| Add: Income from tax credit accretion (at fair value) | 113             | 522             |
| Less: Deliveries made                                 | (5,182)         | (9,362)         |
| Fair value adjustment                                 | 7               | 595             |
| <b>Balance, end of year</b>                           | <b>\$ 3,641</b> | <b>\$ 8,703</b> |

**NOTE 5 SBA LOANS:**

SBA loans are well diversified throughout numerous industries, but have a small concentration in the restaurant industry, as well as geographic concentrations in several states as noted in the table below. On October 1, 2010, the Company elected to utilize the fair value option for SBA loans funded on or after that date creating a new loan pool, SBA loans held for investment, at fair value. The components of SBA loans held for investment, at fair value, and SBA loans held for investment, net, as of December 31, 2013 and 2012 are as follows (in thousands):

|                                      | <b>2013</b>       | <b>2013</b>       | <b>2012</b>       | <b>2012</b>       |
|--------------------------------------|-------------------|-------------------|-------------------|-------------------|
|                                      | <b>Fair Value</b> | <b>Cost Basis</b> | <b>Fair Value</b> | <b>Cost Basis</b> |
| Gross loans receivable               | \$ 83,988         | \$ 13,341         | \$ 46,585         | \$ 18,315         |
| Less: Allowance for loan losses      |                   | (1,811)           |                   | (2,589)           |
| Less: Deferred origination fees, net |                   | (841)             |                   | (1,079)           |
| Less: Fair value adjustment          | (5,037)           |                   | (3,530)           |                   |
| <b>Total</b>                         | <b>\$ 78,951</b>  | <b>\$ 10,689</b>  | <b>\$ 43,055</b>  | <b>\$ 14,647</b>  |

Below is a summary of the activity in the allowance for loan losses, cost basis, for the years ended December 31, 2013 and 2012 (in thousands):

| <b>Allowance for loan losses, cost basis:</b> | <b>2013</b>     | <b>2012</b>     |
|---|-----------------|-----------------|
| Balance, beginning of year                    | \$ 2,589        | \$ 2,900        |
| Provision for loan losses                     | 1,322           | 810             |
| Loans charged-off                             | (2,144)         | (1,169)         |
| Recoveries                                    | 44              | 48              |
| <b>Balance, end of year</b>                   | <b>\$ 1,811</b> | <b>\$ 2,589</b> |
| <br>  |                 |                 |
| Individually evaluated for impairment         | \$ 1,609        | \$ 2,204        |
| Collectively evaluated for impairment         | 202             | 385             |
| <br>  |                 |                 |
| Balance, end of year                          | \$ 1,811        | \$ 2,589        |
| <br>  |                 |                 |
| <b>Total loans, cost basis</b>                |                 |                 |
| Individually evaluated for impairment         | \$ 3,466        | \$ 5,753        |
| Collectively evaluated for impairment         | 9,875           | 12,562          |
| <br>  |                 |                 |
| Balance, end of year                          | \$ 13,341       | \$ 18,315       |

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The contractual maturities of SBA loans held for investment are as follows (in thousands):

|                                | <b>2013</b>       | <b>2013</b>       | <b>2012</b>       | <b>2012</b>       |
|--------------------------------|-------------------|-------------------|-------------------|-------------------|
|                                | <b>Fair Value</b> | <b>Cost Basis</b> | <b>Fair Value</b> | <b>Cost Basis</b> |
| Due in one year or less        | \$                | \$ 319            | \$                | \$ 40             |
| Due between one and five years |                   | 4,509             |                   | 4,534             |
| Due after five years           | 83,988            | 8,513             | 46,585            | 13,741            |
| Total loans receivable, gross  | \$ 83,988         | \$ 13,341         | \$ 46,585         | \$ 18,315         |

The payment status of gross SBA loans held for investment at December 31, 2013 and 2012 are as follows:

|                      | <b>(in thousands)</b> |             |
|----------------------|-----------------------|-------------|
| <b>Days Past Due</b> | <b>2013</b>           | <b>2012</b> |
| Current              | \$ 84,809             | \$ 52,556   |
| 30 - 89              | 4,842                 | 4,251       |
| > 90                 |                       | 1,128       |
| Non-accrual          | 7,678                 | 6,965       |
| Balance (net)        | \$ 97,329             | \$ 64,900   |

The outstanding balances of loans past due over 90 days and still accruing interest as of December 31, 2012 totaled \$1,128,000; there were no performing loans past due over 90 days and still accruing interest as of December 31, 2013.

The Company evaluates the credit quality of its loan portfolio by employing a risk rating system that is similar to the Uniform Classification System which is the asset classification system adopted by the Federal Financial Institution Examinations Council. The Company's risk rating system is granular with multiple risk ratings in both the Acceptable and Substandard categories. Assignment of the ratings are predicated upon numerous factors, including credit risk scores, collateral type, loan to value ratios, industry, financial health of the business, payment history, other internal metrics/analysis, and qualitative assessments.

Risk ratings are refreshed as appropriate based upon considerations such as market conditions, loan characteristics, and portfolio trends. The Company's gross SBA loans held for investment recorded at cost by credit quality indicator at December 31, 2013 and 2012 are as follows:

|                              | <b>(in thousands)</b> |             |
|------------------------------|-----------------------|-------------|
| <b>Risk Rating</b>           | <b>2013</b>           | <b>2012</b> |
| Acceptable                   | \$ 7,420              | \$ 9,153    |
| Other assets special mention | 2,234                 | 2,926       |
| Substandard                  | 3,283                 | 5,894       |
| Doubtful                     | 395                   | 333         |
| Loss                         | 9                     | 9           |

|         |           |           |
|---------|-----------|-----------|
| Balance | \$ 13,341 | \$ 18,315 |
|---------|-----------|-----------|

All loans are priced at the Prime interest rate plus approximately 2.75% to 3.75%. The only loans with a fixed interest rate are defaulted loans of which the guaranteed portion sold is repurchased from the secondary market by the SBA, while the unguaranteed portion of the loans still remains with the Company. As of December 31, 2013 and 2012, net SBA loans receivable held for investment with adjustable interest rates totaled \$91,083,000 and \$58,382,000, respectively.

For the years ended December 31, 2013 and 2012, the Company funded \$177,941,000 and \$107,425,000 in loans and sold approximately \$131,733,000 and \$84,743,000 of the guaranteed portion of the loans, respectively. Receivables from loans traded but not settled of \$13,606,000 and \$16,698,000 as of December 31, 2013 and 2012, respectively, are presented as broker receivable in the accompanying consolidated balance sheets.

As of December 31, 2013, \$23,623,000 of the guaranteed portion of SBA loans and \$12,695,000 of the unguaranteed portion of SBA loans collateralized the current outstanding balance on the Company's line of credit with Capital One and \$60,140,000 of the unguaranteed portions of SBA loans transferred via our securitization transaction collateralized the notes issued by the Trust.

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Loans by industry and geographic concentration that accounted for more than 5% of the outstanding gross loans receivable held for investment balance as of December 31, 2013 and 2012 were as follows (in thousands):

|                 | 2013      | 2012     |
|-----------------|-----------|----------|
| <b>Industry</b> |           |          |
| Restaurants     | \$ 4,688* | \$ 4,569 |
| <b>State</b>    |           |          |
| New York        | \$ 12,813 | \$ 8,178 |
| Florida         | 9,280     | 7,161    |
| Connecticut     | 7,275     | 3,433    |
| Texas           | 6,957     | 5,056    |
| Pennsylvania    | 6,470     | 3,453    |
| Georgia         | 6,450     | 4,579    |
| California      | 6,140     | 4,584    |
| New Jersey      | 5,488     | 5,624    |

(\*) Amounts shown for comparative purposes and represent less than 5%.

At December 31, 2013 and 2012, total impaired loans amounted to \$7,678,000 and \$6,965,000, respectively, of which \$4,212,000 and \$1,212,000 were on a fair value basis at December 31, 2013 and 2012, respectively. For the years ended December 31, 2013 and 2012, the average balance of impaired loans was \$6,887,000 and \$6,935,000, and approximately \$1,609,000 and \$2,204,000 in specific reserves included in the allowance for loan losses and \$163,000 and \$126,000 of SBA fair value discount were allocated against such impaired loans, respectively.

Had interest on these impaired non-accrual loans been accrued, such interest would have totaled \$434,000 and \$407,000 for 2013 and 2012, respectively. Interest income, which is recognized on a cash basis, related to the impaired non-accrual loans for the years ended December 31, 2013 and 2012, was not material.

The Company had loans renegotiated in troubled debt restructurings of \$3,409,000 as of December 31, 2013, of which \$1,332,000 was included in non-accrual loans and \$2,077,000 was on accrual status. The Company had loans renegotiated in TDRs of \$2,661,000 as of December 31, 2012, of which \$750,000 was included in non-accrual loans and \$1,911,000 was on accrual status. The Company has no commitments to loan additional funds to borrowers whose existing loans have been modified in TDR. An analysis of loans restructured in TDR for the years ended December 31, 2013 and 2012 is as follows (in thousands):

| Type of Concession                       | Loans Restructured - 2013 |                                       | Loans Restructured - 2012 |                                       |
|--|---------------------------|---------------------------------------|---------------------------|---------------------------------------|
|  | Number of Notes           | Principal Balance at Restructure Date | Number of Notes           | Principal Balance at Restructure Date |
| Payment reduction / Interest-only period | 4                         | \$ 425                                | 11                        | \$ 428                                |



TDRs that return to a non-performing status post-modification are considered redefaulted loans and are treated in the same manner as other non-performing loans in the portfolio. For the year ending December 31, 2013, the Company had 3 TDR loans that subsequently defaulted with a corresponding principal balance of approximately \$11,000, and resulted in charge-offs of approximately \$4,000. For the year ended December 31, 2012, there were 16 redefaulted loans with a corresponding principal balance of approximately \$2,504,000; there were no corresponding charge-offs of redefaulted loans during 2012.

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**Table of Contents****NOTE 6 ACCOUNTS RECEIVABLE:**

Accounts receivable consists of the following at December 31, 2013 and 2012 (in thousands):

|  | <b>2013</b>      | <b>2012</b>      |
|--|------------------|------------------|
| Purchased receivables                                | \$ 7,766         | \$ 7,617         |
| Electronic payment processing settlement receivables | 2,123            | 2,183            |
| Customer receivables                                 | 1,983            | 1,293            |
| Other receivables                                    | 601              | 339              |
|  | 12,473           | 11,432           |
| Allowance for doubtful accounts                      | (871)            | (561)            |
| <b>Total</b>   | <b>\$ 11,602</b> | <b>\$ 10,871</b> |

**NOTE 7 INVESTMENTS IN QUALIFIED BUSINESSES:**

Included in prepaid expenses and other assets on the consolidated balance sheets are certain investments in qualified businesses, which are presented separately below between their debt and equity components, and a summary of the activity for the years ended December 31, 2013 and 2012 (in thousands):

At December 31, 2012, held to maturity debt investments comprised three long-term loans totaling \$1,532,000 at December 31, 2012 with original principal balances totaling \$1,851,000, and interest rates ranging from 4.25% to 6.00%. There were no held to maturity debt investments at December 31, 2013. Following is a summary of activity for the years ended December 31, 2013 and 2012:

|  | <b>2013</b> | <b>2012</b> |
|--|-------------|-------------|
| Principal outstanding, beginning of year | \$ 1,532    | \$ 13       |
| Investments made                         |             | 1,651       |
| Return of principal, net of recoveries   | (1,532)     | (132)       |
| Principal outstanding, end of year       | \$          | \$ 1,532    |

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The Company has a 49% ownership interest in one equity method investment with a balance of \$226,000 at December 31, 2013. The original amount invested was \$800,000. A summary of activity for the years ended December 31, 2013 and 2012 is as follows:

|  | <b>2013</b>   | <b>2012</b>   |
|--|---------------|---------------|
| Total equity investments, beginning of year  | \$ 175        | \$ 131        |
| Equity in earnings                           | 51            | 44            |
| <b>Total equity investments, end of year</b> | <b>\$ 226</b> | <b>\$ 175</b> |

The Company has not guaranteed any obligation of these investees, and the Company is not otherwise committed to provide further financial support for the investees. However, from time-to-time, the Company may decide to provide such additional financial support which, as of December 31, 2013 was zero. Should the Company determine that impairment exists upon its periodic review, and it is deemed to be other than temporary, the Company will write down the recorded value of the asset to its estimated fair value and record a corresponding charge in the consolidated statements of income. During 2012, the Company made additional investments in two held to maturity debt instruments totaling \$1,651,000. One of the loans, a \$551,000 Bidco investment in an SBA loan, was considered partially funded at December 31, 2012 and was fully funded in 2013. The guaranteed portions of all three of these loans were sold during 2013. During the years ended December 31, 2013 and 2012, the Company received \$1,532,000 and \$132,000 in principal repayments on its debt investments, respectively.

**NOTE 8 SERVICING ASSETS:**

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

The following summarizes the activity pertaining to servicing assets for the years ended December 31, 2013 and 2012 (in thousands):

|                              | <b>2013</b>     | <b>2012</b>     |
|------------------------------|-----------------|-----------------|
| Balance, beginning of year   | \$ 4,682        | \$ 3,420        |
| Servicing assets capitalized | 3,248           | 2,050           |
| Servicing assets amortized   | (1,154)         | (788)           |
| <b>Balance, end of year</b>  | <b>\$ 6,776</b> | <b>\$ 4,682</b> |

For the years ended December 31, 2013, 2012 and 2011, servicing fees received on the Company's SBA 7(a) originated portfolio totaled \$2,769,000, \$2,297,000 and \$1,629,000, respectively. The Company also performs servicing functions on loans originated by other SBA lenders. The Company does not retain any risk on such portfolios and earns servicing fees based upon a mutually negotiated fee per loan. The total servicing fee income recognized for loans serviced for others in 2013, 2012 and 2011 was \$3,796,000, \$4,564,000 and \$1,466,000, respectively. The carrying value of the capitalized servicing assets were \$6,776,000 and \$4,682,000 at December 31, 2013 and 2012, respectively, while the estimated fair value of capitalized servicing assets were \$7,959,000 and

\$6,067,000 at December 31, 2013 and 2012, respectively. The estimated fair value of servicing assets at December 31, 2013 was determined using a discount factor that equates the present value of the expected servicing income to the strip multiple method valuation rate of 11%, weighted average prepayment speeds ranging from 0% to 11%, depending upon certain characteristics of the loan portfolio, weighted average life of 5.00 years, and an average default rate of 3%. The estimated fair value of servicing assets at December 31, 2012 was determined using a discount rate of 11%, weighted average prepayment speeds ranging from 1% to 14%, depending upon certain characteristics of the loan portfolio, weighted average life of 5.00 years, and an average default rate of 5%.

The unpaid principal balances of loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of loans serviced for others within the NSBF originated portfolio were \$372,366,000 and \$271,548,000 as of December 31, 2013 and 2012, respectively. The unpaid principal balances of loans serviced for others which were not originated by NSBF and are outside of the Newtek portfolio were \$561,092,000 and \$176,988,000 as of December 31, 2013 and 2012, respectively.

**Table of Contents****NOTE 9 FIXED ASSETS:**

The Company's fixed assets are composed of the following at December 31, 2013 and 2012 (in thousands):

|   | <b>2013</b> | <b>2012</b> |
|---|-------------|-------------|
| Computer and office equipment             | \$ 2,898    | \$ 3,045    |
| Furniture and fixtures                    | 666         | 636         |
| Leasehold improvements                    | 462         | 384         |
| Computer software and website             | 4,744       | 4,174       |
| Computer servers and storage              | 4,817       | 5,537       |
| Leased property                           | 701         | 632         |
|   | 14,288      | 14,408      |
| Accumulated depreciation and amortization | (10,547)    | (10,885)    |
| Net fixed assets                          | \$ 3,741    | \$ 3,523    |

Depreciation and amortization expense for fixed assets for the years ended December 31, 2013, 2012 and 2011 was \$1,768,000, \$1,619,000 and \$1,816,000, respectively.

Included in computer software and website are certain costs associated with internally developed software. The following table summarizes the activity for capitalized software development costs for the years ended December 31, 2013 and 2012 (in thousands):

|                                 | <b>2013</b> | <b>2012</b> |
|---------------------------------|-------------|-------------|
| Balance, beginning of year      | \$ 3,499    | \$ 3,078    |
| Additions                       | 519         | 421         |
| Balance, end of year            | 4,018       | 3,499       |
| Less: accumulated amortization  | (3,317)     | (2,803)     |
| Software development costs, net | \$ 701      | \$ 696      |

**NOTE 10 GOODWILL AND OTHER INTANGIBLES:**

The net carrying value of goodwill as of December 31, 2013 and 2012 by segment is as follows (in thousands):

|                               | <b>2013</b> | <b>2012</b> |
|-------------------------------|-------------|-------------|
| Electronic payment processing | \$ 3,004    | \$ 3,004    |
| Web hosting                   | 7,203       | 7,203       |
| Corporate activities          | 179         | 179         |
| Small business finance        | 1,706       | 1,706       |

|                |           |           |
|----------------|-----------|-----------|
| Total goodwill | \$ 12,092 | \$ 12,092 |
|----------------|-----------|-----------|

Other intangible assets as of December 31, 2013 and 2012 are comprised of the following (in thousands):

|                               | <b>2013</b> | <b>2012</b> |
|-------------------------------|-------------|-------------|
| Customer merchant accounts    | \$ 2,193    | \$ 5,859    |
| Customer insurance accounts   | 740         | 740         |
| Trade name (indefinite lived) | 550         | 550         |
|                               | 3,483       | 7,149       |
| Accumulated amortization      | (2,243)     | (5,591)     |
| Net intangible assets         | \$ 1,240    | \$ 1,558    |

Customer merchant accounts are being amortized over a 55 to 66 month period, and customer insurance accounts are being amortized over a period of 60 months. Other intangibles (excluding the trade name which has an indefinite life and is subject to annual impairment review) are being amortized over a period ranging from 18 to 36 months. Total amortization expense included in the accompanying consolidated statements of income related to intangibles for the years ended December 31, 2013, 2012 and 2011 was \$363,000, \$629,000 and \$1,363,000, respectively.

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Total expected amortization expense for the next five fiscal years is as follows (in thousands):

| <b>December 31,</b> | <b>Merchant<br/>Accounts</b> | <b>Insurance<br/>Accounts</b> |
|---------------------|------------------------------|-------------------------------|
| 2014                | \$ 55                        | \$ 148                        |
| 2015                | 23                           | 148                           |
| 2016                | 12                           | 148                           |
| 2017                | 6                            | 148                           |
| 2018                | 2                            |                               |
|                     | \$ 98                        | \$ 592                        |

Based upon the Company's performance of the impairment tests using the fair value approach of the discounted cash flow method, the Company determined that goodwill was not impaired for the years ended December 31, 2013, 2012 and 2011. For the years ended December 31, 2013, 2012 and 2011, there was no impairment related to its customer merchant and insurance accounts. The Company's intangible trade name, CrystalTech Web Hosting, has an indefinite life and is assessed annually for impairment.

**NOTE 11 ACCOUNTS PAYABLE, ACCRUED EXPENSES AND OTHER LIABILITIES:**

The following table details the components of accounts payable, accrued expenses and other liabilities at December 31, 2013 and 2012 (in thousands):

|  | <b>2013</b> | <b>2012</b> |
|--|-------------|-------------|
| Due to participants and SBA (a)                                | \$ 2,646    | \$ 1,961    |
| Due to clients (b)   | 481         | 357         |
| Accrued payroll and related expenses                           | 1,865       | 276         |
| Deferred rent  | 841         | 1,293       |
| Chargeback reserves  | 348         | 911         |
| Deposits and other reserves                                    | 1,939       | 1,722       |
| Residuals and commissions payable                              | 1,142       | 1,045       |
| Current tax payable  | 1,533       | 502         |
| Other  | 3,893       | 3,139       |
| Total accounts payable, accrued expenses and other liabilities | \$ 14,688   | \$ 11,206   |

- (a) Primarily represents loan related remittances received by NSBF, and due to third parties; amounts also classified as restricted cash.
- (b) Composed primarily of discount client holdbacks at CDS which represents the difference between the receivables the Company purchases less the actual amount the Company releases to the client, net of the discount fee and other miscellaneous fees charged to the client.

**NOTE 12 NOTES PAYABLE:**

At December 31, 2013 and 2012, the Company had long-term debt outstanding comprised of the following (in thousands):

|   | <b>2013</b> | <b>2012</b> |
|---|-------------|-------------|
| Notes payable:                              |             |             |
| Capital One lines of credit (NSBF)          |             |             |
| Guaranteed line                             | \$ 21,261   | \$ 12,000   |
| Unguaranteed line                           | 4,691       | 11,854      |
| Summit Partners Credit Advisors, L.P. (NBS) | 8,650       | 8,288       |
| Sterling National bank line of credit (NBC) | 6,026       | 6,674       |
| Capital One term loan (NTS)                 | 590         | 1,007       |
| <br>  |             |             |
| Total notes payable                         | 41,218      | 39,823      |
| Note payable Securitization trust VIE       | 60,140      | 22,039      |
| <br>  |             |             |
| Total notes payable                         | \$ 101,358  | \$ 61,862   |



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On April 26, 2012, the Company closed a \$15,000,000 Second Lien Credit Facility (the Facility) issued by Summit Partners Credit Advisors, L.P. (Summit), comprised of a \$10,000,000 term loan, which was drawn at closing, and a \$5,000,000 delayed draw term loan to be made upon the satisfaction of certain conditions. The \$5,000,000 second tranche of this loan will not be drawn by the Company. The funds were used primarily for general corporate purposes including the origination of SBA 7(a) loans. The loan bears interest at 12.5% per annum on the amount outstanding plus payment-in-kind interest at 2.5%, which can either be paid quarterly in arrears or added to the outstanding loan amount. The Facility will mature in 5.5 years and can be prepaid without penalty at any time following the second anniversary of the closing date.

In addition to a second lien on all of the Company's assets behind the first lien held by Capital One, N.A., the principal lender to the Company's SBA lender, NSBF, Summit was given second-lien secured guarantees by each of the Company's principal subsidiaries: NTS and Universal Processing Services of Wisconsin, LLC, as well as certain other smaller subsidiaries. The Company has also committed to attempt to obtain the approval of the SBA for NSBF to provide a guaranty to Summit of the Company's obligations.

Total closing fees were approximately \$1,033,000 which included a 3% fee paid to Summit on the aggregate amount of the Facility, as well as legal, accounting and other closing related costs which were recorded as deferred financing costs and amortized over the life of the facility. The majority of these fees were paid at closing and netted against the initial draw down. Net cash proceeds received at closing were \$9,353,000.

In addition, the Company issued to Summit a warrant representing the right to purchase 1,696,810 common shares, or 4.4% of the Company's current outstanding common equity. The warrant is exercisable at \$0.02 per share, included registration rights and anti-dilution protection, which has been subsequently removed. Summit is prohibited from selling any common shares it receives on exercise of the warrant for a period of 24 months following the closing; provided, however, that if the Company's common shares trade at or above \$2.25 per share for a period of fifteen consecutive days, Summit will have the ability to sell the common shares. Any sales by Summit will be subject to a right of first refusal in favor of the Company. The Facility calls for financial covenants such as minimum EBITDA, maximum capital expenditures, minimum unrestricted cash and cash equivalents, minimum tangible net worth and maximum leverage.

In accordance with ASC 470 and ASC 815, the accounting for these warrants reflects the notion that the consideration received upon issuance must be allocated between the debt and the warrant components based on the fair values of the debt instrument without the warrants and of the warrants themselves at time of issuance. The warrant was originally recorded as a liability, due to an anti-dilution provision and was marked to market on the first reporting date, or June 30, 2012. The remainder of the proceeds was allocated to the debt instrument portion of the transaction. As such, the note was initially valued at \$8,041,000, and the difference of \$1,959,000 was allocated to the value of the warrants and recorded as debt discount, which is being amortized over the life of the note using the interest method. Debt discount amortization for the year ended December 31, 2013 was \$362,000, and is included in interest expense in the Company's consolidated statement of income. The warrant was replaced and the anti-dilutive provision was removed to reflect management and Summit's original understanding and intent related to the warrants. As a result, subsequent to July 1, 2012, the warrants were reclassified to a component of equity and will no longer be marked to market.

Through December 31, 2013, the Company has capitalized \$1,180,000 of deferred financing costs attributable to the Summit facility of which \$331,000 has been amortized and included in interest expense. The net balance of \$849,000 is included in prepaid expenses and other assets in the Company's consolidated balance sheet.

Total interest expense related to the Summit financing for the year ended December 31, 2013 was \$2,085,000, which includes interest, payment-in-kind interest, discount on the valuation of the warrant and amortization of deferred

financing costs.

NBC had a \$10,000,000 line of credit with Wells Fargo ( Wells ) due in February 2012. This facility was used to purchase receivables and for other working capital purposes. In February 2011, NBC entered into a three year line of credit with Sterling National Bank ( Sterling ) in an amount up to \$10,000,000. This facility paid off the Wells line of credit and is and will be used to purchase receivables and for other working capital purposes. In December 2012, an amendment was signed providing

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that upon the occurrence of certain events, the maximum amount of the line of credit under the Agreement can be increased from \$10,000,000 to \$15,000,000 at a later date upon NBC's request. The Amendment also extended the maturity date from February 28, 2014 to February 28, 2016.

As of December 31, 2013 and 2012, NBC had \$6,026,000 and \$6,674,000 outstanding under the lines of credit. The Sterling interest rate is set at 5.00% or Prime plus 2.00%, whichever is higher, with interest on the line to be paid monthly in arrears. The line is and will be collateralized by the receivables purchased, as well as all other assets of NBC. The line is guaranteed by the Company; in addition, the Company deposited \$750,000 with Sterling to collateralize the guarantee. The agreement includes such financial covenants as minimum tangible net worth and maximum leverage ratio. The Company is subject to meeting a maximum leverage ratio test and a future net loss test. As of December 31, 2013, the Company was in compliance with the financial covenants set in this line.

Total interest expense for the years ended December 31, 2013, 2012 and 2011 was approximately \$451,000, \$333,000 and \$283,000, respectively. The weighted average effective interest rate for the year ended December 31, 2013 was 5.85%. Through December 31, 2013, NBC has capitalized \$145,000 of deferred financing costs attributable to the Sterling line of which \$90,000 has been amortized. The net balance of \$55,000 is included in other assets in the accompanying consolidated balance sheet. Amortization for the years ended December 31, 2013, 2012 and 2011 was \$25,000, \$35,000 and \$30,000, respectively, and is included in interest expense in the accompanying consolidated statements of income.

In October 2007, NTS entered into a Loan and Security Agreement with Capital One which provided for a revolving credit facility of up to \$10,000,000 available to both NTS and the Company, for a term of two years. The interest rate was LIBOR plus 2.5% and the agreement included a quarterly facility fee equal to 25 basis points on the unused portion of the Revolving Credit calculated as of the end of each calendar quarter. The agreement included such financial covenants as a minimum fixed charge coverage ratio and a maximum funded debt to EBITDA. NTS capitalized \$65,000 of deferred financing costs attributable to the Capital One line. In connection with the loan, on October 19, 2007 Newtek Business Services, Inc. entered into a Guaranty of Payment and Performance with Capital One Bank and entered into a Pledge Agreement with Capital One pledging all NTS stock as collateral. In October 2009, the \$2,500,000 borrowed under the line of credit converted to a three year term loan, and was subsequently extended to a five year term loan, at the greater of Prime plus 2.50% or 5.75% interest, and maturing on May 1, 2015.

In April 2010, the Company closed two five-year term loans aggregating \$14,583,000 with Capital One of which \$12,500,000 refinanced Newtek Small Business Finance's debt to General Electric Commercial Capital (GE) and \$2,083,000 refinanced the pre-existing term loan between Capital One and NTS. The interest rate on the 2010 NTS term loan is variable based on the monthly LIBOR rate plus 4.25% or Prime plus 2.25%, but no lower than 5.75%. The agreement includes such financial covenants as a minimum fixed charge coverage ratio and minimum EBITDA; the Company guarantees the term loan. The balance of the NTS term loan is included in notes payable on the consolidated balance sheet. As of December 31, 2013 and 2012, \$590,000 and \$1,007,000 of the note was outstanding, respectively. The weighted average effective interest rate at December 31, 2013 was 5.75%. Interest is paid in arrears along with each monthly principal payment due. Total interest expense for the years ended December 31, 2013, 2012 and 2011 was approximately \$46,000, \$70,000 and \$94,000, respectively. Amortization associated with the deferred financing costs attributable to the Capital One line and term loans for the years ended December 31, 2013, 2012 and 2011 was \$9,000, \$10,000 and \$9,000, respectively, and is included in interest expense in the accompanying consolidated statements of income.

Also in December 2010, NSBF entered into a revolving credit facility with Capital One N.A. for \$6,000,000 collateralized by the guaranteed portion of SBA 7(a) loans originated. Upon meeting certain requirements, NSBF has the right to increase the maximum amount under the facility by \$6,000,000 which was exercised in March 2011. The

credit facility is used to fund those portions of SBA 7(a) loans made by NSBF that are guaranteed by the SBA, with funds received on the sale of those guaranteed portions of the SBA 7(a) loans by NSBF reducing the facility. In June 2011, NSBF obtained from Capital One an increase in its total revolving credit facility from \$12,000,000 to \$27,000,000. In October 2011, the term of the revolver was extended by nine months through September 2013, at which time the outstanding balance would have been converted into a three year term loan. In July 2013 the SBA lender, received an extension on the maturity of its warehouse lines of credit, totaling \$27 million, with Capital One, N.A. from September 30, 2013 to May 31, 2015, at which time the outstanding balance will be converted into a three-year term loan. The extension also enhanced the terms of the credit facilities by removing the \$15 million funding sublimit for the non-guaranteed portions of the SBA 7(a) loans NSBF originates, and increasing the advance rate to 55% from 50% for the non-guaranteed portions of the SBA 7(a) loans. As of December 31, 2013 and 2012, NSBF had \$25,952,000 and \$23,854,000 outstanding under the line of credit. The interest rate on the portion of the facility, collateralized by the government guaranteed portion of SBA 7(a) loans, is set at Prime plus 1.00%, and there is a quarterly facility fee equal to 25 basis points on the unused portion of the revolving credit calculated as of the end of each calendar

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quarter. The interest rate on the portion of the facility, collateralized by the non-guaranteed portion of SBA 7(a) loans, is set at Prime plus 1.875%, and there is a quarterly facility fee equal to 25 basis points on the unused portion of the revolving credit calculated as of the end of each calendar quarter. The agreement includes financial covenants at the parent company level with its consolidated subsidiaries including a minimum fixed charge coverage ratio, minimum EBITDA requirements and minimum cash requirements held at Capital One. As of December 31, 2013, the Company was in compliance with the financial covenants set in this line.

Total interest expense for the years ended December 31, 2013 and 2012 was \$886,000 and \$392,000, respectively. Through December 31, 2013, NSBF has capitalized \$675,000 of deferred financing costs attributable to the credit line of which \$436,000 has been amortized. The balance of \$239,000 is included in other assets in the accompanying consolidated balance sheet.

In December 2010, NSBF engaged in a securitization of the unguaranteed portions of its SBA 7(a) loans. In the securitization, it used a special purpose entity (Newtek Small Business Loan Trust 2010-1 or the Trust ) which is a VIE. Applying the consolidation requirements for VIEs under the accounting rules in ASC Topic 860, Transfers and Servicing, and ASC Topic 810, Consolidation, which became effective January 1, 2010, the Company determined that as the primary beneficiary of the securitization vehicle, based on its power to direct activities through its role as servicer for the Trust and its obligation to absorb losses and right to receive benefits, it needed to consolidate the securitization into its financial statements. NSBF therefore consolidated the entity using the carrying amounts of the Trust's assets and liabilities. NSBF continues to recognize the assets in loans held for investment and recognize the associated financing in Bank notes payable.

During the year ended December 31, 2010, NSBF transferred SBA loans held for investment of \$19,615,000, and agreed to transfer \$3,000,000 of future SBA loans held for investment when originated, to the Trust which in turn issued notes for the par amount of \$16,000,000 against the assets. The notes were sold at a dollar price that resulted in gross proceeds before reserve accounts and transaction expenses of \$15,392,000. See Note 5 SBA loans, above, for a description of the loans and loan balances.

In December 2011, NSBF entered into a Supplemental Indenture by which the original \$16,000,000 of securitization notes were amended to reflect a new initial principal amount of \$12,880,000 as a result of principal payments made, and additional notes were issued in an initial principal amount of \$14,899,000, so that the initial aggregate principal amount of all notes as of December 31, 2011 totaled \$27,779,000. The notes were backed by approximately \$40,500,000 of the unguaranteed portions of loans originated and to be originated by NSBF under the SBA loan program. The notes retained their AA rating under S&P, and the final maturity date of the amended notes is March 22, 2037. The initial proceeds of the transaction were used to repay debt, and the balance of the \$5,000,000 prefunding account was used to originate new loans.

In March 2013, the Company completed a third securitization resulting in \$20,909,000 of notes being issued in a private placement transaction. The SBA lender transferred the unguaranteed portions of SBA loans in the amount of \$23,569,000 and an additional \$5,900,000 for new loans to be funded subsequent to the transaction to a special purpose entity, Newtek Small Business Loan Trust 2013-1. The notes received an A rating by S&P, and the final maturity date of the notes is June 25, 2038. The proceeds of the transaction have been and will be used to repay debt and originate new loans.

In December 2013, NSBF completed an additional transaction whereby the unguaranteed portions of SBA loans of \$23,947,000, and an additional \$3,642,000 in loans issued subsequent to the transaction, was transferred to the Trust. The Trust in turn issued securitization notes for the par amount of \$24,433,000 against the assets in a private placement. The notes received an A rating by S&P, and the final maturity date of the amended notes is April 25, 2039.

The proceeds of the transaction have been and will be used to repay debt and originate new loans.

Deferred financing costs associated with the securitization transactions totaled \$2,921,000 and \$1,516,000 at December 31, 2013 and 2012, respectively, of which \$734,000 and \$393,000 has been amortized. The net balance of \$2,187,000 and \$1,123,000 is included in prepaid expenses and other assets on the accompanying consolidated balance sheet. At December 31, 2013 and 2012, the assets (before reserve for loan losses and discount) and liabilities of the consolidated Trust totaled \$60,140,000 and \$22,039,000, respectively.

The Trust is only permitted to purchase the unguaranteed portion of SBA 7(a) loans, issue asset-backed securities, and make payments on the securities. The Trust only issued a single series of securities to pay for the unguaranteed portions it acquired from NSBF and will be dissolved when those securities have been paid in full. The primary source for repayment of the debt is the cash flows generated from the unguaranteed portion of SBA 7(a) loans owned by the Trust; principal on the debt will be

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paid by cash flow in excess of that needed to pay various fees related to the operation of the Trust and interest on the debt. The debt has an expected maturity of about six years based on the expected performance of the underlying collateral and structure of the debt and a legal maturity of 30 years from the date of issuance. The assets of the Trust are legally isolated and are not available to pay NSBF's creditors. However, NSBF continues to retain rights to cash reserves and residual interests in the Trust and will receive servicing income. For bankruptcy analysis purposes, NSBF sold the unguaranteed portions to the Trust in a true sale and the Trust is a separate legal entity. The investors and the Trusts have no recourse to any of NSBF's other assets for failure of debtors to pay when due; however, NSBF's parent, Newtek, has provided a limited guaranty to the investors in the Trust in an amount not to exceed 10% of the original issuance amount (or \$2,778,000), to be used after all of the assets of the Trust have been exhausted. The notes were issued with an AA rating from S&P based on the underlying collateral.

Total expected principal repayments for the next five fiscal years and thereafter are as follows (in thousands):

| <b>December 31,</b> | <b>Notes Payable</b> | <b>Capital Lease</b> | <b>Total</b> |
|---------------------|----------------------|----------------------|--------------|
| 2014                | \$ 22,242            | \$ 235               | \$ 22,477    |
| 2015                | 1,563                | 249                  | 1,812        |
| 2016                | 7,590                | 157                  | 7,747        |
| 2017                | 9,823                | 1                    | 9,824        |
| 2018                |                      |                      |              |
| Thereafter          | 60,140               |                      | 60,140       |
|                     | \$ 101,358           | \$ 642               | \$ 102,000   |

**NOTE 13 NOTES PAYABLE IN CREDITS IN LIEU OF CASH:**

Each Capco has separate contractual arrangements with the Certified Investors obligating the Capco to make payments on the Notes.

At the time the Capcos obtained the proceeds from the issuance of the Notes, Capco warrants or Company common shares to the Certified Investors, the proceeds were deposited into escrow accounts which required that the insurance contracts be concurrently and simultaneously purchased from the insurer before the remaining proceeds could be released to and utilized by the Capco. The Capco Note agreements require, as a condition precedent to the funding of the Notes that insurance be purchased to cover the risks associated with the operation of the Capco. This insurance is purchased from Chartis Specialty Insurance Company and National Union Fire Insurance Company of Pittsburgh, both subsidiaries of Chartis, Inc. (Chartis), an international insurer. Chartis and these subsidiaries are A+ credit rated by S&P. In order to comply with this condition precedent to the funding, the Notes closing is structured as follows: (1) the Certified Investors wire the proceeds from the Notes issuance directly into an escrow account; (2) the escrow agent, pursuant to the requirements under the Note and escrow agreement, automatically and simultaneously funds the purchase of the insurance contract from the proceeds received. The Notes offering cannot close without the purchase of the insurance, and the Capcos are not entitled to the use and benefit of the net proceeds received until the escrow agent has completed the payment for the insurance. Under the terms of this insurance, the insurer incurs the primary obligation to repay the Certified Investors a substantial portion of the debt as well as to make compensatory payments in the event of a loss of the availability of the related tax credits. The Coverage A portion of these contracts makes the insurer primarily obligated for a portion of the liability.

The Capcos, however, are secondarily, or contingently, liable for such payments. The Capco, as a secondary obligor, must assess whether it has a contingency to record on the date of issuance and at every reporting date thereafter until the insurer makes all their required payments. As of December 31, 2013, the insurer has made all of the scheduled cash payments under Coverage A, therefore the contingent liability of the Company has been extinguished.

The Coverage B portion of these contracts provides for the payment of cash in lieu of tax credits in the event the Capco becomes decertified. The Capcos remain primarily liable for the requirement to deliver tax credits (or make cash payments in lieu of tax credits not delivered).

Although Coverage B protects the Certified Investors as described above, the Company remains primarily liable for the portion of this obligation. This liability has been recorded as notes payable in credits in lieu of cash, representing the present value of the Capcos' total liability it must pay to the Certified Investors. Such amount will be increased by an accretion of interest expense during the term of the Notes and will decrease as the Capcos pay interest by delivering the tax credits, or paying cash.



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As discussed in Note 3, the Company adopted fair value option for financial assets and liabilities concurrent with its adoption fair value accounting effective January 1, 2008 for valuing Notes payable in lieu of cash with the exception of Wilshire Advisers, LLC. Following is a summary of activity of Notes payable in credits in lieu of cash balance for the years ended December 31, 2013 and 2012 (in thousands):

|                                    | <b>2013</b>     | <b>2012</b>     |
|------------------------------------|-----------------|-----------------|
| Balance, beginning of year         | \$ 8,703        | \$ 16,948       |
| Add: Accretion of interest expense | 113             | 522             |
| Less: Deliveries of tax credits    | (5,182)         | (9,362)         |
| Fair value adjustment              | 7               | 595             |
| <b>Balance, end of year</b>        | <b>\$ 3,641</b> | <b>\$ 8,703</b> |

Under the Note agreements, no interest is paid by the Capcos in cash provided that the Certified Investors receive the uninterrupted use of the tax credits. The Certified Investors acknowledge, in the Note agreements, that the insurer is primarily responsible for making the scheduled cash payments as provided in the Notes.

**NOTE 14 NON-CONTROLLING INTERESTS:**

The following is the aggregate percentage interest of the non-controlling interests as of December 31, 2013 and 2012 (in thousands):

| <b>Minority-Owned Entity</b>   | <b>% Interest</b> | <b>2013</b>     | <b>2012</b>     |
|--------------------------------|-------------------|-----------------|-----------------|
| Wilshire Alabama Partners, LLC | 00.6%             | \$ 3            | \$ 7            |
| Exponential of New York, LLC   | 61.0%             | 2,088           | 2,326           |
| Other (*)                      |                   | (426)           | (278)           |
| <b>Total</b>                   |                   | <b>\$ 1,665</b> | <b>\$ 2,055</b> |

\* Other includes non-controlling interests in PMTWorks Payroll, LLC, and Secure Cyber Gateway Services, LLC ( OLS ). During 2013, the Company completed a restructure of equity for OLS, formerly 50.1% minority owned, which included the conversion of \$518,000 debt payable to Wilshire Texas Partners, LLC ( WT1 ), a related party, in exchange for a new class of non-voting class B preferred stock and an additional 16.8% share of the common interests of OLS.

**NOTE 15 COMMITMENTS AND CONTINGENCIES:*****Operating and Employment Commitments***

The Company leases office space and other office equipment in several states under operating lease agreements which expire at various dates through 2019. Those office space leases which are for more than one year generally contain scheduled rent increases or escalation clauses.

The following summarizes the Company's obligations and commitments, as of December 31, 2013, for future minimum cash payments required under operating lease and employment agreements (in thousands):

| <b>Year</b>  | <b>Operating<br/>Leases *</b> | <b>Employment<br/>Agreements</b> | <b>Total</b>    |
|--------------|-------------------------------|----------------------------------|-----------------|
| 2014         | \$ 3,081                      | \$ 289                           | \$ 3,370        |
| 2015         | 1,504                         |                                  | 1,504           |
| 2016         | 638                           |                                  | 638             |
| 2017         | 532                           |                                  | 532             |
| 2018         | 309                           |                                  | 309             |
| Thereafter   | 106                           |                                  | 106             |
| <b>Total</b> | <b>\$ 6,170</b>               | <b>\$ 289</b>                    | <b>\$ 6,459</b> |

\* Minimum payments have not been reduced by minimum sublease rentals of \$1,933,000 due in the future under non-cancelable subleases.

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Rent expense for 2013, 2012 and 2011 was approximately \$2,406,000, \$2,459,000, and \$3,748,000, respectively.

Under the amended terms of a Service Agreement, between UPS and Servicer; and amended terms of Merchant Program Processing Agreement, between UPS, Servicer and one of their sponsoring banks, UPS is required to pay minimum fees of \$1,000,000 in total under these agreements during each processing year. The Company's fee payments for the 12-month period ended December 31, 2013, exceeded the minimum required amount under these agreements.

Under the terms of an Independent Sales Organization Agreement and Member Services Provider Agreement between UPS and one of their sponsoring bank, UPS is required to pay monthly minimum fees of \$10,000 during the term of the agreement. The Company exceeded the monthly minimum required amount under the agreement for the year ended December 31, 2013.

Under the amended terms of a Processing Services Agreement between UPS and one of their front-end processors, UPS is required to pay a quarterly minimum of \$68,000 during the term of the amended agreement. The Company's fee payments for the 12-month period ended December 31, 2013, exceeded the minimum required amount under these agreements.

## ***Legal Matters***

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

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

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

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

In May 2013, the automated clearing house ( ACH ) provider used by the Company's payroll processing subsidiary, PMT Payroll, LLC ( PMT ), ceased processing payments which resulted in the inability or refusal of the ACH provider's processing bank to send the corresponding credits to PMT's customers' employees. The total amount debited from PMT's customer accounts and unsuccessfully credited to its customers' employees was approximately \$1,318,000. Upon learning of this failure, PMT and the Company immediately paid all funds owing directly to any of its affected customers' employees. Of this amount, the Company has successfully recovered approximately \$814,000 to date from

the provider's bank. The Company is currently working with legal counsel to recover the remaining funds and has been vigorously working with its customers' banks to process returns. We may also initiate litigation to pursue the claim. At this time, the Company believes it is reasonably possible a loss may occur if the Company is unsuccessful in causing the affected banks to process the remaining returns. While such a loss is possible, the Company does not believe that it is probable or that the amount can be estimated at this time.

**NOTE 16 TREASURY STOCK:**

Shares of common stock repurchased by us are recorded at cost as treasury stock and result in a reduction of equity in our consolidated balance sheet. From time-to-time, treasury shares may be reissued as part of our stock-based compensation programs. When shares are reissued, we use the weighted average cost method for determining cost. The difference between the cost of the shares and the issuance price is added or deducted from additional paid-in capital.

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In November 2011, the Newtek Board of Directors adopted a stock buy-back program authorizing management to enter the market to re-purchase up to 1,000,000 of the Company's common shares. This 1,000,000 share authorization replaces the unexercised portions of two previous authorizations and will terminate in one year. As of December 31, 2013, the Company purchased a total of 802,920 treasury shares under this authorization. The Company reissued 49,241 and 66,760 shares in 2013 and 2012, respectively, in connection with the Company's 401k match program, and during 2013 reissued 27,780 shares related to the exercise of non-qualified stock options, 115,000 shares related to the exercise of incentive stock options, and 15,000 shares of restricted stock. In addition, 472,814 shares that were held by an affiliate were issued to the Company in 2008 as settlement of an outstanding liability and are being held as treasury shares.

**NOTE 17 INCOME PER SHARE:**

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

|   | <b>YEAR ENDED DECEMBER</b> |                     |             |
|---|----------------------------|---------------------|-------------|
|   | <b>2013</b>                | <b>31,<br/>2012</b> | <b>2011</b> |
| <b>The calculations of Net Income (Loss) Per Share were:</b>                |                            |                     |             |
| <u>Numerator:</u>   |                            |                     |             |
| Numerator for basic and diluted EPS income available to common stockholders | \$ 7,528                   | \$ 5,643            | \$ 3,335    |
| <u>Denominator:</u>   |                            |                     |             |
| Denominator for basic EPS weighted average shares                           | 35,295                     | 35,523              | 35,706      |
| Denominator for diluted EPS weighted average shares                         | 37,905                     | 36,747              | 36,073      |
| Net income per share: Basic   | \$ 0.21                    | \$ 0.16             | \$ 0.09     |
| Net income per share: Diluted   | \$ 0.20                    | \$ 0.15             | \$ 0.09     |

The amount of anti-dilutive shares/units excluded from above is as follows (in thousands):

|                              | <b>YEAR ENDED DECEMBER 31,</b> |             |             |
|------------------------------|--------------------------------|-------------|-------------|
|                              | <b>2013</b>                    | <b>2012</b> | <b>2011</b> |
| Stock options                |                                |             | 856         |
| Warrants                     |                                | 50          | 50          |
| Contingently issuable shares | 83                             | 83          | 83          |

**NOTE 18 INCOME FROM TAX CREDITS:**

Each Capco has a contractual arrangement with a particular state or jurisdiction that legally entitles the Capco to earn and deliver tax credits (ranging from 4% to 11% per year) from the state or jurisdiction upon satisfying certain criteria. In fiscal 2013, 2012 and 2011, the Company recognized income from tax credits resulting from the accretion

of the discount attributable to tax credits earned in prior years. As the tax credits are delivered to the Certified Investors, the asset balance is offset against notes payable in credits in lieu of cash. As discussed in Note 3, the Company adopted fair value accounting concurrently with the adoption of fair value option for financial assets and financial liabilities on January 1, 2008 to value its credits in lieu of cash balance. As a result, the income from tax credit accretion for the years ended December 31, 2013, 2012 and 2011 has been recorded at fair value. The total income from tax credits recognized in revenues in the consolidated statements of income was \$113,000, \$522,000, and \$1,390,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

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Provision (benefit) for income taxes for the years ended December 31, 2013, 2012 and 2011 is as follows (in thousands):

|   | <b>2013</b>     | <b>2012</b>     | <b>2011</b>      |
|---|-----------------|-----------------|------------------|
| <b>Current:</b>                                   |                 |                 |                  |
| Federal   | \$ 5,075        | \$ 4,511        | \$ 415           |
| State and local                                   | 132             | 1,519           | 1,263            |
|   | 5,207           | 6,030           | 1,678            |
| <b>Deferred:</b>                                  |                 |                 |                  |
| Federal   | (1,132)         | (1,731)         | (2,441)          |
| State and local                                   | (157)           | (417)           | (432)            |
|   | (1,289)         | (2,148)         | (2,873)          |
| <b>Total provision (benefit) for income taxes</b> | <b>\$ 3,918</b> | <b>\$ 3,882</b> | <b>\$(1,195)</b> |

Included in the 2013 current state provision is a receivable from state tax refunds in the amount of approximately \$1,115,000, which favorably impacted the Company's effective tax rate by approximately 8.6% for the year ended December 31, 2013. This receivable resulted from the amendment of the 2010, 2011 and 2012 tax returns.

A reconciliation of income taxes computed at the U.S. federal statutory income tax rate (35% in 2013, 35% in 2012, and 34% in 2011) to the provision (benefit) for income taxes for the years ended December 31, 2013, 2012 and 2011 is as follows (in thousands):

|   | <b>2013</b>      | <b>2012</b>      | <b>2011</b>      |
|---|------------------|------------------|------------------|
|   | <b>Provision</b> | <b>Provision</b> | <b>Benefit</b>   |
| Provision (benefit) for income taxes at U.S. federal statutory rate of 35% (2012) and 34% (2011 and 2010) | \$ 3,874         | \$ 3,304         | \$ 689           |
| State and local taxes, net of federal benefit   | 399              | 720              | 734              |
| Deferred adjustment true-ups  | 116              |                  |                  |
| Permanent differences   | 91               | 46               | (80)             |
| Deferred tax asset valuation allowance increase (decrease)  | 178              | (185)            | (3,056)          |
| Change in NYC valuation allowance   | (3,370)          |                  |                  |
| Deferred rate true up NYC NOL   | 3,370            |                  |                  |
| Other refund from prior year amended state returns  | (639)            |                  |                  |
| Other   | (101)            | (3)              | 518              |
| <b>Total provision (benefit) for income taxes</b>   | <b>\$ 3,918</b>  | <b>\$ 3,882</b>  | <b>\$(1,195)</b> |

Deferred tax assets and liabilities consisted of the following at December 31, 2013 and 2012 (in thousands):

|  | <b>2013</b>    | <b>2012</b>    |
|--|----------------|----------------|
| <b>Deferred tax assets:</b>  |                |                |
| Net operating losses ( NOLs ) and capital losses (excluding New York City NOL) | \$ 3,199       | \$ 2,919       |
| New York City NOL  | 225            | 4,242          |
| Prepaid insurance  | 217            | 472            |
| Loan loss reserves and fair value discounts                                    | 2,366          | 1,300          |
| Flow through of deferred items from investments in qualified businesses        | 522            | 522            |
| Deferred compensation  | 880            | 599            |
| Loss on investments  |                | 257            |
| Interest payable in credits in lieu of cash                                    | 1,177          | 1,306          |
| Depreciation and amortization  | 897            | 1,383          |
| Other  | 914            | 1,323          |
| <br>   |                |                |
| Total deferred tax assets before valuation allowance                           | 10,397         | 14,323         |
| Less: Valuation allowance  | (3,453)        | (3,275)        |
| Less: Valuation allowance New York City NOL                                    | (225)          | (3,595)        |
| <br>   |                |                |
| <b>Total deferred tax assets</b>   | <b>6,719</b>   | <b>7,453</b>   |
| <br>   |                |                |
| <b>Deferred tax liabilities:</b>   |                |                |
| Credits in lieu of cash  | (2,550)        | (4,571)        |
| Deferred income  | (563)          | (564)          |
| <br>   |                |                |
| <b>Total deferred tax liabilities</b>  | <b>(3,113)</b> | <b>(5,135)</b> |
| <br>   |                |                |
| Net deferred tax asset   | \$ 3,606       | \$ 2,318       |



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As of December 31, 2013, the Company had gross Federal NOLs of approximately \$4,885,000 and state and local NOLs of approximately \$7,294,000 which will begin to expire in 2020, and \$2,796,000 of capital losses with a full valuation allowance which will expire in 2013 and 2014. The Federal NOLs are attributable to NSBF and NBC, of which the NOLs at NBC have a full valuation allowance and the NOLs at NSBF, subject to IRC Section 382 limitations, have a partial valuation allowance.

Realization of the deferred tax assets is dependent on generating sufficient taxable income in future years. The Company had total valuation allowances of approximately \$3,678,000 and \$6,870,000 as of December 31, 2013 and 2012, respectively. The decrease in the New York City valuation allowance represents a reduction in the apportionment rate applicable to NYC NOLs due to the Company filing a combined NYC return beginning in 2012. Additionally the Company believes it is more likely than not that the entire NYC NOL will not be utilized in the future. The remaining change in valuation allowance represents a release in valuation allowance related to NSBF Section 382 NOLs that the Company believes it is more likely than not that it will use, offset by an increase in the valuation allowance for capital losses that the Company believes it is more likely than not it will not use in the future.

The Company analyzed its tax positions taken on their Federal and state tax returns for the open tax years 2010, 2011 and 2012, and used three levels of analysis in determining whether any uncertainties existed with respect to these positions. The first level consisted of an analysis of the technical merits of the position, past administrative practices and precedents, industry norms and historical audit outcome. The second level of analysis was used to determine if the threshold (more than 50%) was met for the tax filing position. The third level of analysis consisted of determining the probable outcome once it was determined that the threshold was met for the tax filing position. Based on our analysis, the Company determined that there were no uncertain tax positions and that the Company should prevail upon examination by the taxing authorities.

The Company's operations have been extended to other jurisdictions. This extension involves dealing with uncertainties and judgments in the application of tax regulations in these jurisdictions. The final resolution of any tax liabilities are dependent upon factors including negotiations with taxing authorities in these jurisdictions and resolution of disputes arising from federal, state and local tax audits. The Company recognizes potential liabilities associated with anticipated tax audit issues that may arise during an examination. Interest and penalties that are anticipated to be due upon examination are recognized as accrued interest and other liabilities with an offset to interest and other expense. The Company determined that there were no uncertainties with respect to the application of tax regulations in these jurisdictions.

**NOTE 20 LEASE RESTRUCTURING CHARGES:**

During 2011, the Company relocated its corporate and lending facility to two smaller spaces in order to reduce its expense and improve its cash flows. Simultaneous with this relocation, on November 1, 2011, the Company entered into a sublease agreement with respect to its offices located at 1440 Broadway, New York, NY. The Company continues to remain obligated under the terms of the original lease. Based on the remaining obligation of the original lease and the estimated sublet income, during 2011 the Company recorded a pretax charge to earnings of approximately \$990,000 upon the cease-use date representing the present value of the amount by which the rent and other direct costs paid by the Company to the landlord exceeds any rent paid to the Company by its tenant under the new sublease over the remainder of the lease term, which expires in October 2015. The Company recorded a credit to rent expense of approximately \$291,000 for each of the years ended December 31, 2013 and December 31, 2012 from the reduction in the accrued lease loss for the year. This amount is included in other general and administrative expense on the consolidated statements of income.

**NOTE 21 BENEFIT PLANS:**

***Defined Contribution Plan***

The Company's employees participate in a defined contribution 401(k) plan (the Plan) adopted in 2004 which covers substantially all employees based on eligibility. The Plan is designed to encourage savings on the part of eligible employees and qualifies under Section 401(k) of the Internal Revenue Code. Under the Plan, eligible employees may elect to have a portion of their pay, including overtime and bonuses, reduced each pay period, as pre-tax contributions up to the maximum

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allowed by law. The Company may elect to make a matching contribution equal to a specified percentage of the participant's contribution, on their behalf as a pre-tax contribution. For the years ended December 31, 2013 and 2012, the Company matched 50% of the first 2% of employee contributions, resulting in \$137,000 and \$108,000 in expense recorded in 2013 and 2012, respectively.

**NOTE 22 RELATED PARTY TRANSACTIONS:**

During the years ended December 31, 2013, 2012, and 2011, the Company provided merchant processing for a company controlled by the father-in-law of a major stockholder and former President of the Company, in the approximate amount of \$15,000, \$27,000 and \$48,000, respectively. In connection with these transactions, the Company recorded a receivable of \$1,000 and \$2,000 at December 31, 2013 and 2012, respectively.

The Company pays gross residuals to an independent sales organization ( ISO ) controlled by a major stockholder of the Company. The ISO earns gross residuals from Newtek, and in turn pays commissions to its sales representatives as well as other operating expenses. Gross residuals paid by the Company to the ISO for the years ended December 31, 2013, 2012 and 2011 were approximately \$3,636,000, \$3,155,000 and \$1,649,000, respectively.

During the years ended December 31, 2013, 2012 and 2011, the Company contracted with PMTWorks, LLC for payroll related services. Certain owners of PMTWorks, LLC also own non-controlling interest in Newtek Payroll Services, LLC, a consolidated VIE. PMTWorks, LLC provided services including operational, administrative, customer support, technical, risk management, sales and marketing and other services in order to assist Newtek Payroll Services, LLC in conducting payroll processing, tax filing, human resource information services, benefits administration, time and labor management and related ancillary business services. The Company paid \$28,000 for these services for the year ended December 31, 2011; there were no corresponding charges for services performed by related parties for the years ended December 31, 2013 and 2012.

The Company may also, from time to time, provide business services to family members or executives of the Company. These transactions are conducted at arm's length and do not represent a material portion of the Company's revenues.

**NOTE 23 STOCK OPTIONS AND RESTRICTED STOCK GRANTED TO EMPLOYEES:**

As of December 31, 2013, the Company had three share-based compensation plans, which are described below. The compensation cost that has been charged against income for those plans was \$784,000, \$543,000 and \$480,000 for the years ended December 31, 2013, 2012 and 2011, respectively, and is included in salaries and benefits and other general and administrative costs in the accompanying consolidated statements of income for stock compensation related to employees and the board of directors, respectively.

The Newtek Business Services, Inc. 2000 Stock Incentive and Deferred Compensation Plan, as amended, (the 2000 Plan ) currently provides for the issuance of awards of restricted shares for up to a maximum of 4,250,000 common shares to employees and non-employees. The issuance of options under this Plan expired on December 31, 2009. All restricted shares or previously granted options are issued at the fair value on the date of grant. Options issued generally have a maximum term that ranges from 2 to 10 years and vesting provisions that range from 0 to 3 years. As of December 31, 2013, there are 2,299,108 shares available for future grant under this plan.

The Newtek Business Services, Inc. 2003 Stock Incentive Plan, as amended, (the 2003 Plan ) currently provides for the issuance of awards of restricted shares or options for up to a maximum of 1,000,000 common shares to employees and non-employees. All restricted shares or options are issued at the fair value on the date of grant. Options issued

generally have a maximum term that ranges from 2 to 10 years and vesting provisions that range from 0 to 3 years. As of December 31, 2013, there were 540,460 shares available for future grant under this plan.

The Newtek Business Services, Inc. 2010 Stock Incentive Plan, (the 2010 Plan ) currently provides for the issuance of awards of restricted shares or options for up to a maximum of 1,650,000 common shares to employees and non-employees. All restricted shares or options are issued at the fair value on the date of grant. Options issued generally have a maximum term that ranges from 2 to 10 years and vesting provisions that range from 0 to 4 years. As of December 31, 2013, there were 241,500 shares available for future grant under this plan.

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A summary of stock option activity under the 2000, 2003 and 2010 Plans as of December 31, 2013 and changes during the year then ended are presented below:

| <b>Stock Options</b>          | <b>Shares<br/>(In thousands)</b> | <b>Weighted Average<br/>Exercise<br/>Price</b> | <b>Weighted Average<br/>Remaining Term<br/>(In years)</b> | <b>Aggregate<br/>Intrinsic Value<br/>(In<br/>thousands)</b> |
|-------------------------------|----------------------------------|--|---|---|
| Outstanding December 31, 2012 | 795                              | \$ 1.44  | 4.68  | 333   |
| Exercised                     | (143)                            | 1.39   |   | \$  |
| Cancelled                     | (60)                             | 1.50   |   |   |
| Outstanding December 31, 2013 | 592                              | \$ 1.45  | 3.25  | \$ 1,002  |
| Exercisable December 31, 2013 | 592                              | \$ 1.45  | 3.25  | \$ 1,002  |

There were no options granted during the years ended December 31, 2013, 2012 and 2011.

As of December 31, 2013, there was \$895,000 of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the 2000, 2003 and 2010 Plans. Of that cost, \$277,000, \$90,000, \$393,000 and \$134,000 is expected to be recognized ratably through July 2014, July 2015, March 2016 and July 2016, respectively.

In March 2011, Newtek granted certain employees, executives and board of directors an aggregate of 1,142,000 shares of restricted stock valued at \$1,941,000 or \$1.70 per share. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the shares vest. The grants are valued using the straight-line method and vest on July 1, 2014. As a result, the Company charged \$497,000, \$465,000 and \$464,000 to income in 2013, 2012 and 2011, respectively, in connection with the vesting period associated with grants that remain outstanding.

In the second quarter of 2012, Newtek granted certain employees and executives an aggregate of 123,000 restricted shares valued at \$184,000. The grants vest on July 1, 2014. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the shares vest. The Company charged \$53,000, \$38,000 and \$25,000 to share-based compensation expense during the years ended December 31, 2013, 2012 and 2011, respectively, in connection with the vesting period associated with grants that remain outstanding.

During the first quarter of 2013, the Company granted certain employees, executives and directors an aggregate of 300,000 restricted shares of common stock valued at \$556,000. The employee and executive grants have a vesting date of March 1, 2016 while the directors vest July 1, 2015. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee's employment. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the

shares vest. The Company recorded \$182,000 in share-based compensation for the year ended December 31, 2013, in connection with the vesting period associated with these grants.

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

During the third quarter of 2013, the Company granted certain employees an aggregate of 70,000 restricted shares of common stock valued at \$176,000 with 10,000 vesting on March 1, 2016 and 60,000 vesting on July 31, 2016. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee's employment. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the shares vest. The Company recorded \$21,000 in share-based compensation for the year ended December 31, 2013 in connection with the vesting period associated with these grants.

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A summary of the status of Newtek's non-vested restricted shares as of December 31, 2013 and changes during the year then ended is presented below:

| <b>Non-vested Restricted Shares</b> | <b>Number of Shares<br/>(in thousands)</b> | <b>Weighted Average<br/>Grant Date Fair<br/>Value</b> |
|-------------------------------------|--|---|
| <b>Non-vested December 31, 2012</b> | 1,148                                      | \$ 1.68   |
| <b>Granted</b>                      | 450  | \$ 2.01   |
| <b>Vested and issued</b>            | (15)                                       | \$ 1.75   |
| <b>Forfeited</b>                    | (95)                                       | \$ 1.76   |
| <b>Non-vested December 31, 2013</b> | 1,488                                      | \$ 1.78   |

**NOTE 24 SEGMENT REPORTING:**

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

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

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

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

The All other segment includes revenues and expenses primarily from qualified businesses that received investments made through the Company's Capcos which cannot be aggregated with other operating segments. The two largest entities in the segment are Newtek Insurance Agency, LLC, an insurance sales operation, and Business Connect, LLC,

a provider of sales and processing services.

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

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



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

the nature of the product and services;

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

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

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

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

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The following table presents the Company's segment information for the years ended December 31, 2013, 2012 and 2011 and total assets as of December 31, 2013 and 2012 (in thousands):

|  | <b>For the year<br/>ended<br/>December 31,<br/>2013</b> | <b>For the year<br/>ended<br/>December 31,<br/>2012</b> | <b>For the year<br/>ended<br/>December 31,<br/>2011</b> |
|--|---|---|---|
| <b>Third Party Revenue</b>               |   |   |   |
| Electronic payment processing            | \$ 89,655   | \$ 85,489   | \$ 82,486   |
| Small business finance                   | 34,112  | 25,408  | 21,025  |
| Managed technology solutions             | 17,576  | 18,211  | 19,184  |
| All Other                                | 2,568   | 1,860   | 1,835   |
| Corporate activities                     | 900   | 785   | 1,092   |
| Capcos                                   | 213   | 683   | 1,497   |
| <b>Total reportable segments</b>         | 145,024   | 132,436   | 127,119   |
| Eliminations                             | (1,431)   | (1,306)   | (1,780)   |
| <b>Consolidated Total</b>                | \$ 143,593  | \$ 131,130  | \$ 125,339  |
| <b>Inter Segment Revenue</b>             |   |   |   |
| Electronic payment processing            | \$ 3,265  | \$ 2,250  | \$ 1,530  |
| Small business finance                   | 520   | 670   | 676   |
| Managed technology solutions             | 526   | 612   | 647   |
| All Other                                | 1,654   | 1,850   | 2,074   |
| Corporate activities                     | 4,753   | 3,684   | 2,794   |
| Capco                                    | 805   | 817   | 806   |
| <b>Total reportable segments</b>         | 11,523  | 9,883   | 8,527   |
| Eliminations                             | (11,523)  | (9,883)   | (8,527)   |
| <b>Consolidated Total</b>                | \$  | \$  | \$  |
| <b>Income (loss) before income taxes</b> |   |   |   |
| Electronic payment processing            | \$ 8,304  | \$ 7,041  | \$ 6,157  |
| Small business finance                   | 10,143  | 8,094   | 4,135   |
| Managed technology solutions             | 3,564   | 4,254   | 4,837   |
| All Other                                | (1,606)   | (1,038)   | (734)   |
| Corporate activities                     | (8,002)   | (7,511)   | (10,170)  |
| Capco                                    | (1,284)   | (1,401)   | (2,197)   |
| <b>Total reportable segments</b>         | 11,119  | 9,439   | 2,028   |
| Eliminations                             | (50)  |   |   |
| <b>Totals</b>                            | \$ 11,069   | \$ 9,439  | \$ 2,028  |

| <b>Depreciation and Amortization</b> |                 |                 |                 |
|--------------------------------------|-----------------|-----------------|-----------------|
| Electronic payment processing        | \$ 358          | \$ 743          | \$ 1,419        |
| Small business finance               | 1,241           | 919             | 893             |
| Managed technology solutions         | 1,316           | 1,214           | 1,387           |
| All Other                            | 203             | 36              | 80              |
| Corporate activities                 | 161             | 118             | 163             |
| Capco                                | 5               | 6               | 13              |
| <b>Totals</b>                        | <b>\$ 3,284</b> | <b>\$ 3,036</b> | <b>\$ 3,955</b> |

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|                                       | For the year<br>ended<br>December 31,<br>2013 | For the year<br>ended<br>December 31,<br>2012 | For the year<br>ended<br>December 31,<br>2011 |
|---------------------------------------|---|---|---|
| <b>Interest (Income) Expense, net</b> |   |   |   |
| Electronic payment processing         | \$ (4)  | \$ (6)  | \$ (11)                                       |
| Small business finance                | 766   | 466   | (515)   |
| Managed technology solutions          | 94  | 80  | 103   |
| All Other                             | (1)   | (2)   | (10)  |
| Corporate activities                  | 24  | 8   | (20)  |
| Capcos                                | 96  | 527   | 1,240   |
| <b>Total reportable segments</b>      | 975   | 1,073   | 787   |
| Eliminations                          | 50  |   |   |
| <b>Consolidated Total</b>             | \$ 1,025                                      | \$ 1,073                                      | \$ 787  |
| <b>Identifiable Assets</b>            |   |   |   |
| Electronic payment processing         | \$ 9,060                                      | \$ 12,465                                     |   |
| Small business finance                | 156,444                                       | 104,155                                       |   |
| Managed technology solutions          | 12,027  | 12,022  |   |
| All Other                             | 3,828   | 1,762   |   |
| Corporate activities                  | 9,357   | 5,726   |   |
| Capco                                 | 7,896   | 16,612  |   |
| <b>Consolidated Total</b>             | \$ 198,612                                    | \$ 152,742                                    |   |

**NOTE 25 QUARTERLY INFORMATION (UNAUDITED):**

The following table sets forth certain unaudited consolidated quarterly statement of income data from the eight quarters ended December 31, 2013. This information is unaudited, but in the opinion of management, it has been prepared substantially on the same basis as the audited consolidated financial statements appearing elsewhere in this report, and all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below. The consolidated quarterly data should be read in conjunction with the current audited consolidated statements and notes thereto. The total of the quarterly EPS data may not equal to the full year results.

| 2013  | Three Months Ended<br>(In Thousands, except Per Share Data) |           |           |           |
|---|---|-----------|-----------|-----------|
|   | 3/31  | 6/30      | 9/30      | 12/31     |
| Total Revenue                               | \$ 34,144   | \$ 37,011 | \$ 34,774 | \$ 37,664 |
| Income before income taxes                  | \$ 2,202  | \$ 2,881  | \$ 1,953  | \$ 4,033  |
| Net income available to common stockholders | \$ 1,452  | \$ 1,842  | \$ 1,820  | \$ 2,414  |
| Income per share Basic                      | \$ 0.04   | \$ 0.05   | \$ 0.05   | \$ 0.07   |
| Income per share Diluted                    | \$ 0.04   | \$ 0.05   | \$ 0.05   | \$ 0.06   |

| <b>2012</b>                                 | <b>Three Months Ended</b>                    |             |             |              |
|---|--|-------------|-------------|--------------|
|   | <b>(In Thousands, except Per Share Data)</b> |             |             |              |
|   | <b>3/31</b>                                  | <b>6/30</b> | <b>9/30</b> | <b>12/31</b> |
| Total Revenue                               | \$ 30,729                                    | \$ 32,338   | \$ 33,458   | \$ 34,605    |
| Income before income taxes                  | \$ 1,633                                     | \$ 1,946    | \$ 2,659    | \$ 3,201     |
| Net income available to common stockholders | \$ 1,019                                     | \$ 1,243    | \$ 1,307    | \$ 2,074     |
| Income per share Basic                      | \$ 0.03                                      | \$ 0.03     | \$ 0.04     | \$ 0.06      |
| Income per share Diluted                    | \$ 0.03                                      | \$ 0.03     | \$ 0.03     | \$ 0.06      |

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