

NEWTEK BUSINESS SERVICES, INC.

Form 10-K

April 01, 2013

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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, 2012

Commission file number: 001-16123

NEWTEK BUSINESS SERVICES, INC.

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

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

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212 West 35th Street, 2nd Floor New York, New York
(Address of principal executive offices)

10001
(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

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 \$32,531,000 as of the last business day of the registrant's second fiscal quarter of 2012.

As of March 29, 2013 there were 35,311,888 shares issued and outstanding of the registrant's Common Shares, par value \$0.02 per share.

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The Company has restated its audited consolidated financial statements and other financial information for the year ended December 31, 2011, and its unaudited condensed consolidated financial statements for the three months ended March 31, 2012, three and six months ended June 30, 2012 and for the three and nine months ended September 30, 2012. This restatement was caused by losses related to understated merchant chargeback reserves in each of the affected periods. The Company identified the matter through an internal review of its chargeback reserves during the 2012 year-end closing process. The incident involved violations of Company policies and procedures by a member of senior management in Universal Processing Services of Wisconsin, LLC, (UPS), d/b/a Newtek Merchant Solutions of WI, in the Electronic payment processing segment which resulted in the understatement of chargeback loss reserves for a group of merchants introduced to the Company by a single independent sales agent. The Company and its Audit Committee retained a consulting firm with extensive expertise in the credit card payments industry to conduct a detailed and in-depth investigation in the areas in which the former employee was involved. Also included was an analysis of the steps appropriate to ensure future compliance with the Company's accounting policies and practices relating to merchant chargeback reserves and to determine if the foregoing matter required modification of its conclusions regarding the effectiveness of the Company's internal control over financial reporting. Both the internal and independent investigations were completed prior to issuance of these financial statements. Based on those investigations it was concluded that the incident was an isolated event specifically related to the one independent sales agent and its group of merchants. There were no other irregularities noted by either the internal or independent reviews that could have affected the Company's consolidated financial results. In addition, the Audit Committee engaged special counsel to review the work of both the internal investigation team and the independent consultant, and advise the Company on the matter and the adequacy of the Company's response in particular. Special counsel issued a report fully coincident with the foregoing conclusions. The Company has begun the collection process to ascertain if any of the loss can be recouped by the Company.

On February 1, 2013, the Company announced the provision for a charge-back loss in its Electronic payment processing segment of \$1.5 million for the year ended December 31, 2012. Subsequent to this announcement, management concluded that the correction of the understatements required the Company restate its financial statements for the periods ended December 31, 2011, March 31, 2012, June 30, 2012 and September 30, 2012, and that this provision for chargeback loss be spread over the affected periods beginning with the fourth quarter of 2011 and throughout 2012. See the further discussion of this matter in Note 26 to the accompanying consolidated financial statements in this Annual Report on Form 10-K. See, also, Item 9A. Controls and Procedures.

The impact over the periods is as follows:

(Amounts In Thousands)	For the			
	Quarter and Year Ended	For the Quarter Ended		
	12/31/11	3/31/12	6/30/12	9/30/12
Electronic Payment Processing Expense	\$ 244	\$ 472	\$ (16)	\$ 275
Income (loss) before income taxes	\$ (244)	\$ (472)	\$ 16	\$ (275)
Net income (loss) available to common stockholders	\$ (146)	\$ (284)	\$ 10	\$ (165)
Income (loss) per share Basic	\$ (0.01)	\$ (0.01)	\$	\$
Income (loss) per share Diluted	\$ (0.01)	\$ (0.01)	\$	\$ (0.01)
Deferred tax asset	\$ 98			
Accounts payable, accrued expenses and other current liabilities	\$ 244	\$ 528	\$ 518	\$ 683

The Company's management has determined that the Company had material weaknesses in its internal control over financial reporting at the end of each such period as described in more detail in Item 9A. Controls and Procedures of this Annual Report on Form 10-K.

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PART I

ITEM 1. BUSINESS.

Overview

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

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

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

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 2012 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 acquire our customers through internal and independent sales teams and referrals through 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 2012, 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.

History

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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, 2012, 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 12. 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 implemented in September 2012. At present, we are placing 190 sixty second commercials on television each month.

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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. 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 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 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 2012 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 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). Notwithstanding our emphasis on our alliance partners as a source of customers, in January 2013 we opened small offices in California and Kentucky consisting of industry professionals in small business lending and merchant processing customer acquisition. We believe that this additional channel will enable these businesses to grow without adding material costs.

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.

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. During 2012 we revised and updated this website to add additional features. 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

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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, 2012, 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.

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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:

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.

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 management services. An additional subsidiary, Small Business Lending, Inc., engages in loan servicing for non-SBA loans.

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.

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 2012, we processed merchant transactions with a sales volume exceeding \$4.2 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 14,100 merchants at the end of 2012. 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. We intend to build the growth and increased profitability of this segment with Mr. Turille's expertise and knowledge.

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.

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Because we are not a bank, we are unable to belong to and directly access the Visa® and MasterCard® bankcard associations and we must be sponsored by a bank in order to process bankcard transactions. We are currently registered with Visa® and MasterCard® 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.

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 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.

During 2012 we continued 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 2012 in integrating 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.

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 increasing emphasis in 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.

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 132,000 customer accounts in 120 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, among others. Ninety percent of all fees are paid in advance by credit card.

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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 relating to Microsoft 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 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.

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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® 2008 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 SASE 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.

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).

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 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

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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.

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. During November 2012, the FDIC was successful in selling a significant group of loans with our assistance. 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 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, 2012, we were servicing approximately \$110,400,000 in loans under this contract, in addition to the other approximately \$418,300,000 loans we service.

In December 2010 and December 2011, NSBF structured a securitization transaction which enabled it to sell approximately \$43,500,000 of the unguaranteed portions of loans it has originated in previous years. The securities sold were rated AA by S&P. A second securitization transaction was completed in March 2013 wherein NSBF sold approximately \$23,569,000 of the unguaranteed portions of additional loans with an additional pool of \$5,880,000 of funding for future loans. These securities were sold with an A-rating by S&P. 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. We expect to continue this process as market and other conditions permit.

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. In addition, NBC offers back office receivables services for small businesses, such as billing and cash collections.

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 as an agent for third party providers and are not taking on credit risk in connection with these services.

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, E-Insure, 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 2011 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 2012 to approximately 355 customers in 35 states with total payroll under management of approximately 1,660 employees, of which approximately 20% were Newtek employees, an increase in customer count of 393% and employee count of 137%. These payroll services are being marketed through all of our available channels including the alliance partnerships and our direct marketing campaigns.

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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. 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 specialists 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, and Morgan Stanley Smith Barney, using our proprietary NewTracker referral system as well as direct referrals from our new web presence, 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 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.

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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. 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.

In September 2012 Newtek also selected Ocean Media, LLC as their 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, Angieslist.com and Overstock.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 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.

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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

Pershing

Members 1st Federal Credit Union

Ent Federal Credit Union

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