NEWTEK BUSINESS SERVICES INC
Form 10-Q
November 13, 2008
Table of Contents

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2008

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission File Number: 001-16123

NEWTEK BUSINESS SERVICES, INC.

(Exact name of registrant as specified in its charter)

New York	**11-3504638**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1440 Broadway, 17th floor, New York, NY	**10018**
(Address of principal executive offices)	**(Zip Code)**

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

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

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

Large Accelerated Filer ¨	**Accelerated Filer ¨**
Non-Accelerated Filer ¨	**Smaller reporting company x**

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

As of November 7, 2008, there were 37,031,656 of the Company s Common Shares issued and outstanding.

Table of Contents

CONTENTS

Table of Contents

Item 1. Financial Statements

NEWTEK BUSINESS SERVICES, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(In Thousands, except for Per Share Data)

	Three Months ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Operating revenues	$ 24,243	$ 23,067	$ 72,393	$ 68,287
Operating expenses:				
Electronic payment processing costs	13,075	11,344	38,224	31,742
Salaries and benefits	5,052	5,775	17,616	16,512
Interest	2,333	3,636	6,816	11,296
Depreciation and amortization	1,772	1,688	5,348	4,896
Other operating costs	4,737	5,347	13,840	15,628
Total operating expenses	26,969	27,790	81,844	80,074
Operating loss from continuing operations before fair market value adjustment, minority interest, (provision) benefit for income taxes, and discontinued operations	(2,726)	(4,723)	(9,451)	(11,787)
Net change in fair market value of credits in lieu of cash and notes payable in credits in lieu of cash	(74)		(13)	
Minority interest	109	91	335	271
Loss from continuing operations before (provision) benefit for income taxes and discontinued operations	(2,691)	(4,632)	(9,129)	(11,516)
(Provision) benefit for income taxes	(56)	669	1,706	2,758
Loss from continuing operations	(2,747)	(3,963)	(7,423)	(8,758)
Discontinued operations, net of taxes		(4)		(495)
Net loss	$ (2,747)	$ (3,967)	$ (7,423)	$ (9,253)
Weighted average common shares outstanding:				
Basic and diluted	35,628	35,950	35,771	35,824
Loss per share from continuing operations:				
Basic and diluted	$ (0.08)	$ (0.11)	$ (0.21)	$ (0.25)
Loss per share from discontinued operations, net of taxes:				
Basic and diluted				(0.01)
Basic and diluted loss per share	$ (0.08)	$ (0.11)	$ (0.21)	$ (0.26)

See accompanying notes to these unaudited condensed consolidated financial statements.

Table of Contents

NEWTEK BUSINESS SERVICES, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, 2008 AND DECEMBER 31, 2007

(In Thousands, except for Per Share Data)

	September 30, 2008 Unaudited	December 31, 2007 (Note 1)
ASSETS		
Cash and cash equivalents	$ 17,825	$ 25,372
Restricted cash	9,704	12,948
Credits in lieu of cash	61,148	92,781
SBA loans held for investment (net of reserve for loan losses of $2,779 and $2,196, respectively)	26,980	27,895
Accounts receivable (net of allowance of $596 and $321, respectively)	4,290	3,957
SBA loans held for sale	6,116	360
Prepaid and structured insurance		14,738
Prepaid expenses and other assets (net of accumulated amortization of deferred financing costs of $2,011 and $1,593, respectively)	10,152	9,789
Servicing asset (net of accumulated amortization and allowances of $3,792 and $3,160, respectively)	2,228	2,718
Fixed assets (net of accumulated depreciation and amortization of $8,792 and $6,616, respectively)	5,172	5,433
Intangible assets (net of accumulated amortization of $11,073 and $8,775, respectively)	7,226	8,829
Goodwill	13,069	12,996
Total assets	$ 163,910	$ 217,816
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Accounts payable and accrued expenses	$ 8,544	$ 10,259
Notes payable	26,685	26,765
Deferred revenue	2,314	2,032
Notes payable in credits in lieu of cash	61,148	79,085
Deferred tax liability	5,766	17,880
Total liabilities	104,457	136,021
Minority interest	4,484	4,970
Commitments and contingencies		
Shareholders 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, issued and outstanding 36,185 and 36,081, respectively, not including 403 and 583 shares held in escrow, respectively, and 473 held by an affiliate)	724	722
Additional paid-in capital	56,398	56,161
(Deficit) retained earnings	(1,504)	20,245
Treasury stock, at cost (633 and 217 shares, respectively)	(649)	(303)
Total shareholders equity	54,969	76,825
Total liabilities and shareholders equity	$ 163,910	$ 217,816

See accompanying notes to these unaudited condensed consolidated financial statements.

Table of Contents

NEWTEK BUSINESS SERVICES, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(In Thousands)

	2008	2007
Cash flows from operating activities:		
Net loss	$ (7,423)	$ (9,253)
Adjustments to reconcile net loss to net cash used in operating activities:		
Income from tax credits	(4,634)	(3,958)
Accretion of interest expense	5,287	8,947
Deferred income taxes	(2,562)	(3,771)
Depreciation and amortization	5,348	5,471
Gain on sale/recovery of investments	(93)	(1,073)
Provision for loan losses	1,528	607
Other, net	(35)	(131)
Changes in operating assets and liabilities:		
Originations of SBA loans held for sale	(16,067)	(22,791)
Proceeds from sale of SBA loans held for sale	10,311	23,227
Prepaid expenses and other assets, accounts receivable and accrued interest receivable	(412)	1,392
Accounts payable, accrued expenses and deferred revenue	(1,365)	(1,838)
Other, net	228	1,094
Net cash used in operating activities	(9,889)	(2,077)
Cash flows from investing activities:		
Investments in qualified businesses	(885)	(1,031)
Return of investments in qualified businesses	859	3,787
Purchase of fixed assets and customer merchant accounts	(2,733)	(4,882)
SBA loans originated for investment, net	(5,169)	(6,832)
Payments received on SBA loans	4,102	5,047
Change in restricted cash	2,889	(545)
Proceeds from sale of SBA loans held for investment		2,144
Proceeds from sale/recovery of investments in qualified businesses		1,032
Proceeds from sale of asset held for sale		1,572
Proceeds from sale of U.S. Treasury Notes		5,042
Other		863
Net cash (used in) provided by investing activities	(937)	6,197

Table of Contents

NEWTEK BUSINESS SERVICES, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007 (CONTINUED)

	2008	2007
Cash flows from financing activities:		
Proceeds from notes payable		5,073
Repayments of notes payable	(338)	(8,766)
Change in restricted cash relating to CDS financing		2,050
Purchase of treasury shares	(458)	(52)
Net proceeds (repayments) on bank notes payable	4,226	(754)
Other	(151)	(191)
Net cash provided by (used in) financing activities	3,279	(2,640)
Net (decrease) increase in cash and cash equivalents	(7,547)	1,480
Cash and cash equivalents - beginning of period	25,372	26,685
Cash and cash equivalents - end of period	$ 17,825	$ 28,165
Supplemental disclosure of cash flow activities:		
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	$ 14,314	$ 14,146
Conversion of note payable to minority interest	$	$ 1,000
Shares held in escrow released to former shareholders of wholly owned subsidiary	$ 72	$ 104
Issuance of treasury shares for 401K match	$ 112	$
Reduction of structured insurance product and notes payable Certified Investors	$ 3,810	$
Effects of CDS Business Services, Inc. consolidation (excludes intercompany balances):		
Additions to assets:		
Cash	$	$ 233
Accounts receivable		4,311
Prepaid expenses and other assets		94
Total assets	$	$ 4,638
Additions to liabilities:		
Accounts payable and accrued expenses	$	$ 3,127
Notes payable		3,259
Total liabilities		6,386
Goodwill recognized	$	$ 1,748

See accompanying notes to these unaudited condensed consolidated financial statements.

Table of Contents

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION:

Newtek Business Services, Inc. (Newtek or the Company) is a holding company for several wholly- and majority-owned subsidiaries, including 14 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 of 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.

Effective January 1, 2008, the Company changed its basis of presentation for its business segments. For additional information see Note 13 to the Condensed Consolidated Financial Statements.

The Company s principal business segments are:

Electronic Payment Processing: Credit card and debit card processing, check conversion and ACH solutions for the small- and medium-sized business market.

Web Hosting: CrystalTech Web Hosting, Inc., which offers shared and dedicated web hosting and related services to the small- and medium-sized business market.

Small Business Finance: 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. CDS Business Services, Inc., D/B/A Newtek Business Credit (NBC) provides financing to small- and medium-sized businesses by purchasing their receivables at a discounted rate. In addition, NBC provides billing and accounts receivable maintenance services to businesses.

All Other: Includes results from businesses formed from Investments in Qualified Businesses made through Capco programs which cannot be aggregated with other operating segments.

Corporate Activities: Revenue and expenses not allocated to other segments, including interest income, Capco management fee income and corporate expenses.

Capcos: Fourteen certified capital companies which invest in small- and medium-sized businesses. They generate non-cash income from tax credits and non-cash interest expense.

The condensed consolidated financial statements of Newtek Business Services, Inc., its subsidiaries and FIN 46 consolidated entities, (Financial Accounting Standards Board (FASB) issued Interpretation (FIN) No. 46 Consolidation of Variable Interest Entities), included herein have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America and include all wholly- and majority-owned subsidiaries, and those portfolio companies over which the Company has effective control but which the Capcos own non-controlling minority interest, or those of which Newtek is considered to be the primary beneficiary (as defined under FIN 46 and FIN 46R). All inter-company balances and transactions have been eliminated in consolidation. Currently, the Company is absorbing losses attributable to certain of its minority interest holders. Once these entities achieve profitability, the losses will be restored to the Company prior to allocation of profits to all minority holders.

The accompanying notes to condensed consolidated financial statements should be read in conjunction with Newtek s 2007 Annual Report on Form 10-K. These financial statements have been prepared in accordance with instructions to Form 10-Q and Article 10 of Regulations S-X and, therefore, omit or condense certain footnotes and other information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America. The results of operations for an interim period may not give a true indication of the results for the entire year. The December 31, 2007 consolidated balance sheet has been derived from the audited financial statements of that date, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

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

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, chargeback 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.

Change in Accounting Principle

During the first quarter of fiscal 2008, we elected to change our accounting principle to recognize the sale of guaranteed portions of SBA loans on the trade date. Prior to the first quarter of fiscal 2008, we recognized these transactions in our condensed consolidated financial statements on the settlement date. We concluded that use of the trade date was preferable to the settlement date as recognition of the sale at the trade date better reflects the risks and rewards of the transfer of ownership. In accordance with Statement of Financial Accounting Standards (SFAS) No. 154, Accounting Changes and Error Corrections , this change in accounting principle has been applied retrospectively to our condensed consolidated financial statements for all prior periods. As historically traded loans have settled in the same period, this change in accounting principle had no effect on previously reported operating income, net earnings, shareholders equity or cash flows.

Revenue Recognition

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

Electronic payment processing revenue: Electronic payment processing 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 chargebacks or returns, monthly minimum fees, statement fees and fees for other miscellaneous services. In accordance with Emerging Issues Task Force (EITF) 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent , 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.

The Company also derives revenues from acting as independent sales offices (ISO) for third-party processors (residual revenue) and from the sale of credit and debit card devices. Residual revenue is recognized monthly, based on contractual agreements with such processors to share in the residual income derived from the underlying merchant agreements. Revenues derived from sales of equipment are recognized at the time of shipment to the merchant.

Web hosting revenue: Web hosting revenues are primarily derived from monthly recurring service fees for the use of our web hosting 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 is generally received one month to three years in advance. Deferred revenues represent customer prepayments for upcoming web hosting and related services.

Income from tax credits: Following an application process, a state will notify a company that it has been certified as a Capco. The state 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 legally entitled to earn tax credits upon satisfying defined investment percentage thresholds within specified time requirements and corresponding non-recapture percentages. At September 30, 2008, the Company had Capcos in seven states and the District of Columbia. Each state statute requires that the Capco invest a threshold percentage of Certified Capital in Qualified Businesses 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 recapture of all or a portion of the allocated tax credits; the proportion of the 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 continues to make 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

Table of Contents

income from tax credits , with a corresponding asset called credits in lieu of cash , in the accompanying condensed consolidated balance sheets. 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) under the state statute. 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 available to the Certified Investors. If the tax credits are earned before the state is required to make delivery (i.e., investment requirements are met ahead of schedule, but credits can only be used by the certified investor in a future year), then the present value of the tax credits earned are recorded upon completion of the requirements, in accordance with Accounting Principles Board Opinion No. 21. The receivable (called credits in lieu of cash) is accreted to the annual deliverable amount which can then be delivered to the insurance company investors in lieu of cash interest. Delivery of the tax credits to the Certified Investors results in a decrease of the receivable and the notes payable in credits in lieu of cash.

The allocation and utilization of Capco tax credits is controlled by the state law. In general, the Capco applies for tax credits from the state and is allocated a specific dollar amount of credits which are available to be earned. The Capco provides the state with a list of the Certified Investors, who have contractually agreed to accept the tax credits in lieu of cash interest payments on their notes. The tax credits are claimed by the Certified Investors on their state premium tax return as provided under each state Capco and tax law. State regulations specify the amount of tax credits a Certified Investor can claim and the period in which they can claim them. Each state periodically reviews the Capco s operations to verify the amount of tax credits earned. In addition, the state maintains a list of Certified Investors and therefore has the ability to determine whether the Certified Investor is allowed to claim this deduction.

Sales and Servicing of SBA Loans: NSBF originates loans to customers under the SBA program that generally provides for SBA guarantees of 50% to 85% of each loan, subject to a maximum guarantee amount. NSBF sells the guaranteed portion of each loan to third parties and retains the unguaranteed principal portion in its own portfolio. A gain is recognized on these loans through collection on sale of a premium over the adjusted carrying value. Commencing on January 1, 2008, the Company began to recognize the gain on sale of the guaranteed portion of the loans on the trade date rather than the date of settlement. Such transactions are recorded under the terms of SFAS No. 156 (SFAS No. 156), Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140 and are recorded as a component of servicing fee and premium on loan sales in the condensed consolidated statements of operations. In each loan sale, NSBF retains servicing responsibilities and receives servicing fees of a minimum of 1% of the guaranteed loan portion sold. NSBF is required to estimate its servicing compensation in the calculation of its servicing asset. The purchasers of the loans sold have no recourse to NSBF for failure of customers to pay amounts contractually due.

In accordance with SFAS No. 156, upon sale of the loans to third parties, NSBF separately recognizes at fair value any servicing assets or servicing liabilities first, and then allocates the previous carrying amount between the assets sold and the interests that continue to be held by the NSBF (the unguaranteed portion of the loan) based on their relative fair values at the trade date. The difference between the proceeds received and the allocated carrying value of the financial assets sold is recognized as a gain on sale of loans.

Each class of servicing assets and liabilities are subsequently measured using either the amortization method or the fair value measurement method. The amortization method, which NSBF has chosen to continue applying to its servicing asset, amortizes the asset in proportion to, and over the period of, the estimated future net servicing income on the underlying sold portion of the loans (guaranteed) and assesses 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, additional amortization or impairment charges would be recognized. The Company uses an independent valuation specialist to estimate the fair value of the servicing asset.

In evaluating and measuring impairment of servicing assets, NSBF stratifies its servicing assets based on year of loan and loan term which are key risk characteristics of the underlying loan pools. The fair value of servicing assets is determined 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 unamortized 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 an impairment for a stratum is other than temporary, the value of the servicing asset and any related valuation allowance is written-down.

Table of Contents

Interest and Small Business Administration (SBA) Loan Fees SBA Loans: Interest income on loans is recognized as earned. Loans are placed on non-accrual status if they are 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 collectibility of such principal or interest is unlikely. 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 income. While a loan is classified as non-accrual and the future collectibility of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding.

NSBF passes through to the borrower certain expenditures it incurs, such as forced placed insurance or 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 NSBF 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 qualified investments. Revenue is recorded when there is credible evidence of an agreement, the related fees are fixed, the service and/or product have been delivered, and the collection of the related receivable is assured.

The detail of total operating revenues included in the condensed consolidated statements of operations is as follows for the three and nine months ended:

	Three months ended September 30:		Nine months ended September 30:	
(In thousands):	**2008**	**2007**	**2008**	**2007**
Electronic payment processing	$ 15,969	$ 13,955	$ 47,073	$ 39,502
Web hosting	4,586	4,164	13,361	11,984
Interest income	744	1,291	2,547	4,329
Income from tax credits	1,680	1,337	4,634	3,958
Premium on loan sales	(5)	685	472	2,198
Servicing fee	438	512	1,360	1,452
Insurance commissions	225	204	818	648
Other income	606	919	2,128	4,216
Totals	$ 24,243	$ 23,067	$ 72,393	$ 68,287

Electronic Payment Processing Costs

Electronic payment processing costs consist principally of costs directly related to the processing of merchant sales volume, including interchange fees, VISA and MasterCard dues and assessments, bank processing fees and costs paid to third-party processing networks. Such costs are recognized at the time the merchant transactions are processed or when the services are performed. Two of the most significant components of electronic processing expenses include interchange and assessment costs, which are set by the credit card associations. Interchange costs are passed on to the entity issuing the credit card used in the transaction and assessment costs are retained by the credit card associations. Interchange and assessment fees are billed primarily as a percent of dollar volume processed 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 with such third-party referral sources, but 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 typically ongoing as long as the referred merchant remains a customer of the Company and are recognized as expenses as related revenues are recognized in the Company s condensed consolidated statements of operations.

Restricted Cash

Restricted cash includes cash collateral relating to a letter of credit; monies due on 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; and a cash account maintained as a reserve against chargeback losses.

Purchased Receivables

Purchased receivables are recorded at the point in time when cash is released to the seller. A majority of the receivables purchased have recourse and are charged back to the seller if aged over 60, 90 or 120 days, depending on contractual agreements. Purchased receivables are included in accounts receivable on the condensed consolidated balance sheet.

Investments in Qualified Businesses

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

Consolidation Method. Investments in which the Company directly or indirectly owns more than 50% of the outstanding voting securities, those the Company has effective control over, or those deemed to be a variable interest entity in which the Company is the primary beneficiary under the provisions of FIN 46R (FIN 46 consolidated entity) are generally accounted for under the consolidation method of accounting. Under this method, an investment s financial position and results of operations are reflected within the Company s condensed consolidated financial statements. All significant inter-company accounts and transactions are eliminated, including returns of principal, dividends, interest received and investment redemptions. The results of operations and cash flows of a consolidated operating entity are included through the latest interim period in which the Company owned a greater than 50% direct or indirect voting interest, exercised control over the entity for the entire interim period or was otherwise designated as the primary beneficiary. Upon dilution of control below 50%, or upon occurrence of a triggering event requiring reconsideration as to the primary beneficiary of a variable interest entity, the accounting method is adjusted to the equity or cost method of accounting, as appropriate, for subsequent periods.

Equity Method. 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 condensed consolidated financial statements; however, the Company s share of the earnings or losses of the investee is reflected in the Company s condensed consolidated financial statements.

Cost Method. 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 condensed consolidated financial statements. However, cost method impairment charges are recognized, as necessary, in the Company s condensed consolidated financial statements. If circumstances suggest that the value of the investee has subsequently recovered, such recovery is not recorded until ultimately liquidated or realized.

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

Table of Contents

Stock - Based Compensation

The Company applies SFAS 123 (revised 2004), Share-Based Payment (SFAS 123R). SFAS 123R requires all share-based payments to employees to be recognized in the financial statements based on their fair values using an option-pricing model at the date of grant.

As of September 30, 2008, the Company had two share-based compensation plans. For the three and nine month periods ended September 30, 2008, compensation cost charged to operations for those plans was $49,000 and $206,000, respectively, and is included in salaries and benefits in the accompanying condensed consolidated statements of operations.

In March 2008, Newtek granted its six independent directors an aggregate of 197,434 options valued at $87,000. Option awards are granted with an exercise price equal to the market price of the Company s stock at the date of grant. The options vest immediately and expire 10 years from the date of grant. The fair value of each option award is estimated on the date of grant using a Black-Scholes option valuation model that uses the following assumptions: 5 year expected life, risk-free interest rate of 2.51% and expected volatility of the Company s stock of 53.48%. Expected volatilities are based on the historical volatility of the Company s stock and other factors. The risk-free rate for periods during the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Expected term was determined using the simplified method under Staff Accounting Bulletin No. 107, Valuation of Share-Based Payment Arrangements for Public Companies

In May 2008, Newtek granted its certain employees an aggregate of 710,000 options valued at $369,000. Option awards were granted with an exercise price of $1.50 which exceeded the market price of the Company s stock at the date of grant. The options vest on the second anniversary of date of grant and expire 10 years from the date of grant. The fair value of each option award is estimated on the date of grant using a Black-Scholes option valuation model that uses the following assumptions: 6 year expected life, risk-free interest rate of 3.10% and expected volatility of the Company s stock of 53.98%. Expected volatilities are based on the historical volatility of the Company s stock and other factors. The risk-free rate for periods during the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Expected term was determined using the simplified method under Staff Accounting Bulletin No. 107, Valuation of Share-Based Payment Arrangements for Public Companies . Compensation cost charged to operations in connection with such grant was $43,000 and $65,000 for the three and nine month period ended September 30, 2008, respectively.

In July 2008, Newtek granted certain employees an aggregate of 120,000 options valued at $42,000. Option awards were granted with an exercise price of $1.50 which exceeded the market price of the Company s stock at the date of grant. The options vest on the second anniversary of date of grant and expire 10 years from the date of grant. The fair value of each option award is estimated on the date of grant using a Black-Scholes option valuation model that uses the following assumptions: 6 year expected life, risk-free interest rate of 3.20% and expected volatility of the Company s stock of 54.66%. Expected volatilities are based on the historical volatility of the Company s stock and other factors. The risk-free rate for periods during the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Expected term was determined using the simplified method under Staff Accounting Bulletin No. 107, Valuation of Share-Based Payment Arrangements for Public Companies . Compensation cost charged to operations in connection with such grant was $4,000 for the three and nine months ended September 30, 2008.

As of September 30, 2008, there was $313,000 of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized ratably through the period ending September 30, 2010.

New Accounting Pronouncements

In October 2008, the FASB issued FSP No. FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP No. FAS 157-3), which clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP No. FAS 157-3 is effective upon issuance, including prior periods for which financial statements have not been issued. Revisions resulting from a change in the valuation technique or its application should be accounted for as a change in accounting estimate following the guidance in SFAS No. 154, Accounting Changes and Error Corrections (SFAS No. 154). However, the disclosure provisions in SFAS No. 154 for a change in accounting estimate are not required for revisions resulting from a change in valuation technique or its application. The Company adopted SFAS No. 157 in January 2008. As part of this adoption, the Company evaluated the fair value measurements of its financial assets and liabilities and determined that these instruments are valued in active markets. As such, the guidance in this FSP did not impact the Company s consolidated financial statements.

In September 2008, the FASB ratified EITF Issue No. 08-5, Issuer s Accounting for Liabilities Measured at Fair Value With a Third-Party Credit Enhancement (EITF 08-5). EITF 08-5 provides guidance for measuring liabilities issued with an attached third-party credit enhancement (such as a guarantee). It clarifies that the issuer of a liability with a third-party credit enhancement (such as a guarantee) should not include the effect of the credit enhancement in the fair value measurement of the liability. EITF 08-5 is effective for the first reporting period beginning after December 15, 2008. The Company is currently assessing the impact of EITF 08-5 on its condensed consolidated financial position and results of operations.

In February 2008, the FASB issued FSP No. FAS 157-2, Effective Date for FASB Statement No. 157 (FSP No. FAS 157-2). This FSP permits the delayed application of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, as defined in this FSP, except for those that are recognized or disclosed at fair value in the financial statements at least annually, until January 1, 2009 for the Company. As of January 1, 2008, the Company adopted SFAS No. 157, with the exception of its application to nonfinancial assets and nonfinancial liabilities, which the Company will defer in accordance with FSP No. FAS 157-2. The Company is currently evaluating the impact of adopting SFAS No. 157 at the beginning of fiscal 2009 for such nonfinancial assets and nonfinancial liabilities on its condensed consolidated financial statements.

Effective January 1, 2008, the Company adopted SFAS No. 157, Fair Value Measurements (SFAS 157) and SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 157 defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States of America (GAAP) and enhances disclosures about fair value measurements. Fair value is defined under SFAS 157 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 159 allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a

Table of Contents

contract-by-contract basis. The impact of adopting both SFAS 157 and SFAS 159 reduced the beginning balance of retained earnings as of January 1, 2008 by $14.3 million, net of tax. Subsequent changes in fair value of these financial assets and liabilities are recognized in earnings when they occur. For additional information on the fair value of certain financial assets and liabilities, see Note 3 of the condensed consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (R), Business Combinations (SFAS 141(R)), and SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements (SFAS 160). SFAS 141(R) requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. SFAS 160 clarifies that a noncontrolling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of earnings per share will continue to be based on income attributable to the parent. SFAS 141(R) and SFAS 160 are effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. We do not expect the adoption of SFAS 141(R) and SFAS 160 to have a material impact on our condensed consolidated financial statements.

NOTE 3 FAIR VALUE MEASUREMENT

Effective January 1, 2008, the Company adopted SFAS 157 concurrent with its adoption of SFAS 159. SFAS 157 clarifies the definition of fair value and describes methods available to appropriately measure fair value in accordance with GAAP. SFAS 157 applies whenever other accounting pronouncements require or permit fair value measurements. SFAS 159 allows entities to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities that are not otherwise required to be measured at fair value, with changes in fair value recognized in earnings as they occur. SFAS 159 establishes presentation and disclosure requirements designed to improve comparability between entities that elect different measurement attributes for similar assets and liabilities. The Company has adopted SFAS 159 effective January 1, 2008 concurrent with the adoption of SFAS 157 for valuing its Capcos credits in lieu of cash, notes payable in credits in lieu of cash and prepaid insurance with the exception of those related to its Wilshire Advisers, LLC Capco. The discussion below is therefore exclusive of Wilshire Advisors, LLC.

The Company adopted SFAS 159 in order to reflect in its 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 insurance subsidiaries of American International Group, Inc (AIG), namely its A- rating, for the Capcos 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 SFAS 159 and the concurrent adoption of SFAS 157, 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. SFAS 157 requires the fair value of the assets or liabilities to be determined based on the assumptions that market participant s 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 AIG insurance subsidiaries 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 an AIG insurance subsidiary 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 an applicable AIG insurance subsidiary U.S. Dollar denominated debt instrument or, because such an instrument does not exist, an applicable AIG holding company U.S. Dollar denominated debt instrument. Because the value of notes payable in credits in lieu of cash directly reflects the credit enhancement obtained from the AIG insurance subsidiaries, the unamortized cost relating to the credit enhancement will cease to be separately carried as an asset on Company s consolidated balance sheet and is incorporated in notes payable in credits in lieu of cash.

The following table summarizes the impact of the change in accounting for credits in lieu of cash, prepaid insurance and notes payable in credits in lieu of cash, and the impact of adopting the fair value option for certain financial instruments on January 1, 2008. Amounts shown represent the carrying value of the affected instruments before and after the changes in accounting resulting from the adoption of SFAS 157 and SFAS 159.

Table of Contents

Transition impact:

(In thousands:)	Ending Balance Sheet December 31, 2007	Adoption Net Gain/(Loss)	Opening Balance Sheet January 1, 2008
Impact of electing the fair value option under SFAS 159			
Credits in lieu of cash	$ 92,781	$ (4,013)	$ 88,768
Prepaid insurance	14,738	(11,006)	3,732
Notes payable in credits in lieu of cash	(79,085)	(8,859)	(87,944)
Cumulative-effect adjustment (pre-tax)		(23,878)	
Tax impact		9,551	
Cumulative-effect adjustment (net of tax), decrease to retained earnings		$ (14,327)	

The fair value at September 30, 2008 was calculated using fair value hierarchy level two and in the same manner as the valuation at January 1, 2008 with modifications as described below.

Fair Value Option

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

The Company elected to account for both credits in lieu of cash and notes payable in credits in lieu of cash at fair value in accordance with SFAS 159 in order to reflect in its consolidated financial statements the assumptions that market participant s use in evaluating these financial instruments.

Prepaid insurance

The Company has determined that the effect of the credit enhancement obtained from AIG is inseparable from the notes payable in credits in lieu of cash. In adopting SFAS 159 the prepaid insurance unamortized cost relating to the credit enhancement ceased to be separately carried as an asset on the Company s condensed consolidated balance sheet and is incorporated in notes payable in credits in lieu of cash.

Fair Value Measurement

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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.

As described above, the Company s Capcos debt, enhanced by AIG insurance, effectively bears the nonperformance risk of 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 Company elected to discontinue utilizing AIG s 7.70% Series A-5 Junior Subordinated Debentures (the AIG Debentures) because those long maturity debentures began to trade with characteristics of a preferred stock after the AIG received financing from the United States Government. The Company considers this a level 2 input under SFAS 157, since it is a quoted yield for a similar liability that is traded in an active exchange market. The Company selected these AIG securities as the most representative of the nonperformance risk associated with the CAPCO notes because they are AIG 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. 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.

As of June 30, 2008, the present value of the credits in lieu of cash was $79,908,000 and notes payable in credits in lieu of cash was $79,772,000. On that date, the yield on the AIG Debentures was 8.63%. As of September 30, 2008, the date the Company revalued the asset and liability, the yields on the AIG notes averaged 21.97% reflecting AIG s reduction in credit rating from AA- to A-, AIG s financial troubles, and changes in interest rates in the marketplace. This increase in yield reduced both the fair value of the credits in lieu of cash by $15,158,000 to $62,422,000 from an expected value of $77,580,000 assuming the yield had remained unchanged from June 30, 2008, and the fair value of the notes payable in credits in lieu of cash by $16,358,000 to $61,148,000 from an expected value of $77,506,000 assuming the yield had remained unchanged from June 30, 2008. The Company reduced the value of the credits in lieu of cash by an additional $1,274,000 to equal the value of the notes payable in credits in lieu of cash. The net change in fair value reported in the Company s condensed consolidated statement of operations for the three months ended September 30, 2008 above was a loss of $74,000.

Changes in the future yield of the AIG 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 condensed consolidated statements of operations.

Table of Contents

NOTE 4 SBA LOANS:

The Company lends to a variety of business types with the largest concentrations by dollar amount of SBA loans in the hotel and motel and restaurant industries. Geographically, the Company holds loans in 40 states and the District of Columbia with the largest concentrations by dollar amount in Florida and New York. Below is a summary of the activity in the SBA loans held for investment, net of SBA loan loss reserves for the nine months ended September 30, 2008 (In thousands):

Balance at December 31, 2007	$ 27,895
SBA loans originated for investment	5,233
Payments received	(4,102)
Provision for SBA loan losses	(1,528)
Loans foreclosed into real estate owned	(682)
Discount on loan originations, net	164
Balance at September 30, 2008	$ 26,980

Below is a summary of the activity in the reserve for loan losses for the nine months ended September 30, 2008 (In thousands):

Balance at December 31, 2007	$ 2,196
SBA loan loss provision	1,528
Recoveries	39
Loan charge-offs	(984)
Balance at September 30, 2008	$ 2,779

Below is a summary of the activity in the SBA loans held for sale for the nine months ended September 30, 2008 (In thousands):

Balance at December 31, 2007	$ 360
Loan originations for sale	16,067
Loans sold	(10,311)
Balance at September 30, 2008	$ 6,116

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 September 30, 2008 and December 31, 2007, net SBA loans receivable held for investment with adjustable interest rates amounted to $25,520,000 and $25,806,000, respectively.

For the nine months ended September 30, 2008 and 2007, the Company funded approximately $21,172,000 and $29,919,000 in loans and sold approximately $10,311,000 and $23,421,000 of the guaranteed portion of the loans, respectively.

The outstanding balances of loans past due ninety days or more and still accruing interest as of September 30, 2008 and December 31, 2007 amounted to $91,000 and $273,000, respectively.

At September 30, 2008 and December 31, 2007, total impaired non-accrual loans amounted to $5,359,000 and $5,550,000, respectively. For the nine months ended September 30, 2008 and for the year ended December 31, 2007, the average balance of impaired non-accrual loans was $5,985,000 and $5,637,000, respectively. Approximately $1,661,000 and $1,008,000 of the allowance for loan losses were allocated against such impaired non-accrual loans, respectively, in accordance with SFAS 114 Accounting by Creditors for Impairment of a Loan an amendment of FASB Statement No. 5 and 15 . The following is a summary of SBA loans held for investment as of:

(In thousands):	September 30, 2008	December 31, 2007
Due in one year or less	$ 64	$ 64
Due between one and five years	1,392	1,392
Due after five years	29,972	30,468
Total	31,428	31,924
Less : Allowance for loan losses	(2,779)	(2,196)
Less: Deferred origination fees, net	(1,669)	(1,833)
Balance (net)	$ 26,980	$ 27,895

16

Table of Contents

NOTE 5 SERVICING ASSETS:

Servicing rights are recognized as assets when SBA loans are sold and the rights to service those loans are retained. As of January 1, 2007, the Company adopted the provisions of SFAS 156 which requires all separately recognized servicing assets to be initially measured at fair value, if practicable. As of January 1, 2007, the Company identified its entire balance in servicing rights as one class of servicing assets for this measurement. The Company reviews capitalized servicing rights for impairment which 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 term and year of loan origination.

The changes in the value of the Company s servicing rights for the nine months ended September 30, 2008 were as follows:

(In thousands):	
Balance at December 31, 2007	$ 3,099
Servicing assets capitalized	142
Servicing assets amortized	(752)
Balance at September 30, 2008	2,489
Reserve for impairment of servicing assets:	
Balance at December 31, 2007	(381)
Recovery	120
Balance at September 30, 2008	(261)
Balance at September 30, 2008 (net of reserve)	$ 2,228

The estimated fair value of capitalized servicing rights was $2,228,000 and $2,718,000 as of September 30, 2008 and December 31, 2007, respectively. The estimated fair value of servicing assets as of September 30, 2008 was determined using a discount rate of 12.7%, weighted average prepayment speeds ranging from 1% to 22%, weighted average life of 3.0 years, and an average default rate of 4.9%. The estimated fair value of servicing assets at December 31, 2007 was determined using a discount rate of 11.2%, weighted average prepayment speeds ranging from 1% to 23 %, depending upon certain characteristics of the loan portfolio, a weighted average life of 3 years, and an average default rate of 4.9%. The Company considers its determination of the estimated fair value of capitalized servicing rights to be a level 3 input under SFAS 157.

The unpaid principal balances of loans serviced for others which are not included in the accompanying condensed consolidated balance sheets amounted to $139,822,000 and $155,182,000 as of September 30, 2008 and December 31, 2007, respectively.

NOTE 6 NOTES PAYABLE:

As of September 30, 2008, NSBF failed to maintain the Minimum Senior Charge Coverage Ratio specified in Annex G and Section 6.10 of the Credit Agreement, dated August 31, 2005 among NSBF General Electric Capital Corporation and certain other Credit Parties (GE), as amended (the GE line of credit), and notified GE of the occurrence of an event of default under the GE line of credit.

Table of Contents

GE has informed NSBF that it reserves all rights and remedies available to it under the GE line of credit in respect of the event of default. To date, GE has not restricted NSBF from drawing down on the GE line of credit to meet commitments, but there can be no assurance that GE will continue to do so. As of November 4, 2008, NSBF had $28,325,551 outstanding under the GE line of credit. Please see Liquidity and Capital Resources for a fuller discussion of this event.

NOTE 7 COMMON STOCK:

In connection with restricted stock grants in 2007, the Company issued 4,762 shares to one employee for the three months ended September 30, 2008 and issued 38,109 shares to three employees for the nine months ended September 30, 2008. The allocated portion of the related compensation costs associated with these grants were $2,000 and $30,000 for the three and nine months ended September 30, 2008, respectively.

NOTE 8 WARRANTS:

In March 2008, a warrant was granted to purchase 50,000 shares of the Company s common stock to a firm performing investor relations for the Company. The warrant vests in six months with an exercise price of $2.00 and expires in March 2018. At September 30, 2008, the warrant was valued at $12,000. The compensation cost that has been charged to operations for this warrant for the three and nine months ended September 30, 2008 was $4,000 and $12,000, respectively, and is included in other operating costs in the accompanying condensed consolidated statements of operations. The fair value of each warrant award is estimated on the date of grant using a Black-Scholes option valuation model that uses the following assumptions: 10 year expected life, risk-free interest rate of 3.45% and expected volatility of the Company s stock of 63.76%. Expected volatilities are based on the historical volatility of the Company s stock and other factors. The risk-free rate for periods during the expected life of the warrant is based on the U. S. Treasury yield curve in effect at the time of grant. The expected term was determined based on the contractual term of the warrant. In accordance with EITF 96-18, the Company adjusted the value of the warrant to fair value at each measurement date through the date of vesting, which was September 15, 2008.

NOTE 9 TREASURY STOCK:

Shares of common stock repurchased by the Company are recorded at cost as treasury stock and result in a reduction of shareholders equity in our condensed consolidated balance sheets. From time-to-time, treasury shares may be reissued as part of our stock-based compensation programs. When shares are reissued, the Company uses the weighted average cost method for determining cost. The difference between the cost of the shares and the issuance price is charged to compensation expense and added or deducted from additional contributed capital.

In March 2006, 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. As of September 30, 2008, the Company has purchased a total of 633,152 treasury shares under that authorization.

NOTE 10 INCOME TAXES:

During the third quarter of 2008, the Company changed its estimated effective annual tax rate as a result of changes in its estimated annualized taxable income. The Company s annual effective tax rate was reduced from approximately 27% to 19%. The change is primarily the result of an increase in the estimated annual loss at NSBF, an entity that does not consolidate with Newtek Business Services, Inc. for tax purposes, and reductions in operating expenses in other entities which improved pre-tax results and produced a current tax provision.

NOTE 11 LOSS PER SHARE:

Basic loss 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 loss per share only when the effect of their inclusion would be dilutive.

Table of Contents

The calculations of loss per share were:

(In thousands except per share data):	Three months Ended September 30: 2008	Three months Ended September 30: 2007	Nine months Ended September 30: 2008	Nine months Ended September 30: 2007
Numerator:				
Numerator for basic and diluted EPS loss from continuing operations	$ (2,747)	$ (3,963)	$ (7,423)	$ (8,758)
Numerator for basic and diluted EPS loss from discontinued operations		(4)		(495)
Numerator for basic and diluted EPS loss available to common shareholders	$ (2,747)	$ (3,967)	$ (7,423)	$ (9,253)
Denominator:				
Denominator for basic and diluted EPS weighted average shares	35,628	35,950	35,771	35,824
Net loss per share from continuing operations: Basic and diluted	$ (0.08)	$ (0.11)	$ (0.21)	$ (0.25)
Net loss per share from discontinued operations: Basic and diluted				(0.01)
Loss per share: Basic and diluted	$ (0.08)	$ (0.11)	$ (0.21)	$ (0.26)

The amount of anti-dilutive shares/units excluded from above is as follows:

Stock options and restricted stock	1,856	703	1,658	617
Warrants	216	216	216	216
Contingently issuable shares	403	474	403	474

NOTE 12 SUBSEQUENT EVENTS:

On October 20, 2008, NBC entered into a Second Amendment and Waiver of Defaults with Wells Fargo Bank, NA dated February 27, 2007, that extends the $10,000,000 facility by three years to February 2012. The agreement also provides for the opportunity to convert all or any part of the principal amount outstanding into a LIBOR advance at a rate of LIBOR plus 350 basis points or remain at Prime rate, with a floor of 5.00% plus 250 basis points.

On October 21, 2008, NSBF entered into a Third Amendment and Waiver of its Credit Agreement with General Electric Capital Corporation dated August 31, 2005 (the GE Amendment). The GE Amendment increases the interest rate by 50 basis points immediately to LIBOR plus 300 basis points or the Prime Rate plus 75 basis points with an increase of an additional 25 basis points on January 1, 2009 and each quarter thereafter.

NOTE 13 SEGMENT REPORTING:

Operating segments are organized internally primarily by the type of services provided, and in accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, the Company has aggregated similar operating segments into six reportable segments: Electronic payment processing, Web hosting, Small business finance, All other, Corporate, and Capcos.

19

Effective in the first quarter of 2008, the Company made certain changes to its segment reporting to more accurately portray the operation of its businesses. For all segments other than Corporate, intercompany expenses are now charged to the user of the service with a resulting reduction in expense for the provider of the service; no revenue is recorded. Previously the provider showed the expense. This change will better match expenses to the revenues generated by a segment. In addition, the Company moved two finance-related businesses from it s All other segment to the Small business finance segment and renamed it such. The new name better characterizes the financing services provided by the segment: the entities consolidated into the segment provide small- and medium-sized businesses with loans of various types including SBA 7a loans as well as receivables financing and earn fees for servicing loans for other lenders. Segment reporting for the current and previous periods reflect these changes.

Historically a substantial amount of resources were dedicated to new Capcos and the investment of the proceeds in qualified businesses and the managing of these businesses. Since management does not anticipate any new Capcos in the foreseeable future, the Company has changed its internal reporting to better evaluate and manage the existing Capco business, its corporate activities and its portfolio of small businesses included in the All other segment. The segment previously called Capco and other, which Management previously evaluated as one integrated segment, is now being evaluated as three segments Capcos, Corporate activities and All other. The segment information for prior periods has been restated to conform to the current disclosure.

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 expenses, all of which are included in the respective caption on the condensed consolidated statements of operations.

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

The Small business finance segment consists of Small Business Lending, Inc., a lender that primarily originates, sells and services government guaranteed SBA 7a loans to qualifying small businesses through its licensed SBA lender,; the Texas Whitestone Group which manages the Company s Texas Capco and closes loans; 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 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 condensed consolidated statements of operations. 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 condensed consolidated statements of operations.

The All Other segment includes revenues and expense 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 15 Capcos, generates non-cash income from tax credits, interest income and gains from investments in qualified businesses which are included in other income. Expenses primarily include non-cash interest and insurance expense, management fees paid to Newtek (and included in the Corporate activities revenues), legal, and auditing fees and losses from investments in qualified businesses.

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

- the nature of the product and services;

20

Table of Contents

- 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.

Table of Contents

The following table presents the Company s segment information for the three and nine month periods ended September 30, 2008 and total assets as of September 30, 2008 and December 31, 2007 (In thousands):

	For the three months ended September 30, 2008	For the three months ended September 30, 2007	For the nine months ended September 30, 2008	For the nine months ended September 30, 2007
Third Party Revenue				
Electronic payment processing	$ 15,984	$ 14,011	$ 47,134	$ 39,638
Web hosting	4,590	4,173	13,373	12,011
Small business finance	1,647	2,724	5,592	8,967
Capcos	1,755	1,570	4,993	4,926
All other	402	706	1,708	3,094
Corporate activities	1,169	760	4,729	2,992
Total reportable segments	25,547	23,944	77,529	71,628
Eliminations	(1,304)	(877)	(5,136)	(3,341)
Consolidated Total	$ 24,243	$ 23,067	$ 72,393	$ 68,287
Inter-Segment Revenue				
Electronic payment processing	$ 19	$ 10	$ 55	$ 33
Web hosting	56	36	134	131
Small business finance	80		849	23
Capcos	458	510	1,423	1,662
All other	235	232	594	479
Corporate activities	519	306	1,600	1,564
Total reportable segments	1,367	1,094	4,655	3,892
Eliminations	(1,367)	(1,094)	(4,655)	(3,892)
Consolidated Total	$	$	$	$
Income (loss) before benefit for income taxes and discontinued operations				
Electronic payment processing	$ 1,114	$ 917	$ 3,361	$ 2,787
Web hosting	898	317	2,249	2,150
Small business finance	(1,494)	(162)	(3,787)	(264)
Capcos	(1,411)	(2,913)	(5,530)	(9,785)
All other	(575)	(304)	(1,526)	191
Corporate activities	(1,223)	(2,487)	(3,896)	(6,595)
Totals	$ (2,691)	$ (4,632)	$ (9,129)	$ (11,516)
Depreciation and amortization				
Electronic payment processing	$ 558	$ 519	$ 1,679	$ 1,409
Web hosting	808	759	2,441	2,223
Small business finance	277	301	863	886
Capcos	10	10	71	161
All other	23	32	260	187
Corporate activities	96	67	34	30
Totals	$ 1,772	$ 1,688	$ 5,348	$ 4,896

Table of Contents

Identifiable assets	As of September 30, 2008	As of December 31, 2007
Electronic payment processing	$ 15,341	$ 16,234
Web hosting	14,362	17,220
Small business finance	47,611	44,955
Capcos	74,992	125,931
All other	8,014	10,942
Corporate activities	3,590	2,534
Consolidated total	$ 163,910	$ 217,816

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

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.

This Quarterly Report on Form 10-Q contains forward-looking statements. Additional written or oral forward-looking statements may be made by Newtek from time to time in filings with the Securities and Exchange Commission or otherwise. The words believe, expect, seek, and intend and similar expressions identify forward-looking statements, which speak only as of the date the statement is made. Such forward-looking statements are within the meaning of that term in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements may include, but are not limited to, projections of income or loss, expenditures, acquisitions, plans for future operations, financing needs or plans relating to our services, as well as assumptions relating to the foregoing. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. Future events and actual results could differ materially from those set forth in, contemplated by or underlying the forward-looking statements. Newtek does not undertake, and specifically disclaims, any obligation to publicly release the results of revisions which may be made to forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after such statements.

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

We are a direct distributor of business services to the small- and medium-sized business market. Our target market represents a very significant marketplace in the United States GDP. According to statistics published by the U.S. Small Business Administration, approximately 51% of the GDP and private sector employment in the United States comes from small businesses, and 99% of businesses in the United States which have one or more employees fit into this market segment. As of September 30, 2008, we had over 91,000 customers. We use state-of-the-art web-based proprietary technology to be a low cost acquirer and provider of products and services to our small- and medium-sized business clients. We partner with AIG, Merrill Lynch, Morgan Stanley, the Credit Union National Association with its 8,700 credit unions and 80 million members, Navy Federal Credit Union with 2.7 million members, PSCU Financial Services, Inc., the nation s largest credit union service organization, Fiserv Solutions, Inc. d/b/a IntegraSys, General Motors Minority Dealers Association and Daimler Chrysler Minority Dealers Association, all of whom have elected to offer certain of our business services and financial products rather than provide some or all of them directly for their customers. 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.

In order to more accurately and transparently portray our financial information and performance, we have simplified the format of this Form 10-Q and expanded our segment reporting from that used in 2007. We have simplified our condensed consolidated statements of operations by substantially reflecting the operating performance while expanding the segment profit and loss tables to fully show each segment s revenues and expenses. Management s discussion and analysis concentrates on describing segment performance with the aid of these new detailed tables. For expenses other than corporate overhead, intercompany expenses are now charged to the user of the service with a resulting reduction in expense for the provider of the service; for comparability we restated previous segment results to reflect this change as well. We believe this change will better match expenses to the revenues generated by a segment. In addition, we moved two finance-related businesses from our All other segment to the SBA lending segment, now renamed Small business finance. This change recognizes that we have expanded our financing offerings to small- and medium-sized businesses to include multiple loan types and receivables financing and consolidated their management under one operating team. The new name better characterizes this. We also elected to reclassify certain residual fees paid to independent sales agencies and organizations for electronic payment processing accounts they provided to our Electronic payment processing segment from professional fees to electronic payment processing costs; present and previous financial results reflect this change.

As of January 1, 2008, we adopted SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities to better value our Capco notes. By revaluing our assets and liabilities associated with the notes issued by our Capcos, we have endeavored to eliminate much of the non-cash effect the Capcos have on our operations that make unclear the performance of our operations. The adoption has resulted in a one-time, non-cash after-tax reduction in retained earnings of $14,327,000 and a one-time reduction of $9,551,000 in the deferred tax liability. This will reduce the future burden of non-cash Capco losses by better balancing the non-cash income from tax credits against the non-cash Capco interest expense. For the nine months ended September 30, 2008, the change has resulted in a $6,616,000 reduction of the Capco non-cash loss that is income from tax credits less Capco interest expense and the amortization of prepaid Capco note insurance expense. Because we chose to adopt a new rule, we have not restated previous financial results.

For the quarter ended September 30, 2008, we had a net loss of $2,747,000 on revenues of $24,243,000. Total revenues increased by $1,176,000, or 5.1%, from $23,067,000 for the quarter ended September 30, 2007 principally due to increased revenues in the Electronic payment processing and Web hosting segments, offset by decreases in revenues from our Small business finance and All other segments. The reduction in the net loss of $1,220,000 from the third quarter of 2007 reflects improvements in income from operations for the Electronic payment processing segment from increased sales, improvements in income from operations for the Web hosting segment, a reduction in loss in the Capco segment from the adoption of SFAS 159, a reduction in losses in Corporate activities from reduced expenses, offset by greater losses in the Small business finance and All other segments as compared to the same period for 2007. The improved income in the Web hosting segment resulted from increased sales and the elimination of duplicative rent and electricity incurred in the 2007 period in connection with a move to a larger server facility.

The Small business finance segment sold substantially fewer loans held for sale while experiencing a material decrease in the premium received and servicing income created upon NSBF s sale of guaranteed portions of loans because of marketplace conditions. As a result of this, on September 30, 2008, NSBF failed to maintain the minimum Senior Charge Coverage Ratio (SCCR) specified in the GE line of Credit and notified GE of the occurrence of an Event of Default under the agreement with GE (Event of Default). We use the GE line of credit to originate and fund the guaranteed and unguaranteed portions of loans held by NSBF. The Company guarantees up to $15 million of the advances on the line. As of November 4, 2008, we had approximately $28 million outstanding under the GE line of credit. Following an Event of Default, GE has the option of terminating the GE line of credit as to new advances, modifying its terms, or declaring all amounts outstanding under the GE line of credit to be immediately due and payable. To date, GE has taken no action to restrict NSBF from drawing further advances on the GE line of credit to meet commitments, but there can be no assurance that GE will continue to do so or that it will not take other actions as permitted by the GE line of credit. If GE were to take certain actions in respect of such default, it may have a materially negative impact on our SBA lending business and the Company itself.

Finally, in June 2008 the insurer of our Wilshire Advisors, LLC Capco made its single scheduled cash payment to that Capco s investor extinguishing its debt except for a small amount of tax credits to be delivered. As a result, both the Prepaid and structured insurance asset and the Notes payable liability were reduced by $3,810,000, the amount of the payment to the investor. As of June 30, 2008, the Company had voluntarily decertified Wilshire Advisors, LLC.

The Company s reportable business segments are:

Electronic Payment Processing: Credit card and debit card processing, check conversion and ACH solutions for the small- and medium-sized business market

Table of Contents

Web Hosting: CrystalTech Web Hosting, Inc., which offers shared and dedicated web hosting and related services to the small- and medium-sized business market.

Small Business Finance: Newtek Small Business Finance, Inc., a nationally licensed, U.S. Small Business Administration lender that originates, sells and services loans to qualifying small businesses, which are partially guaranteed by the SBA. Texas Whitestone Group performs the closing function for all SBA 7a loans underwritten by NSBF. CDS Business Services, Inc. (d/b/a Newtek Business Credit) provides financing services to businesses by purchasing their receivables at a discounted rate. In addition, the Company provides billing and accounts receivable maintenance services to businesses.

All Other: Includes results from businesses formed from Investments in Qualified Businesses made through Capco programs which cannot be aggregated with other operating segments.

Corporate Activities: Revenue and expenses not allocated to our other segments, including interest income, Capco management fee income and corporate operations expenses.

Capcos: Fifteen 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 (with the adoption of SFAS 159 the amount of insurance expense reported for all Capcos but Wilshire Advisers, LLC has been eliminated starting with the quarter ended March 31, 2008).

Table of Contents

Segment Results:

The results of the Company s reportable segments for the three and nine months ended September 30, 2008 and 2007 are discussed below.

Electronic Payment Processing

(In thousands):	Three months ended September 30: 2008	2007	$ Change	% Change
Revenue:				
Electronic payment processing	$ 15,968	$ 13,955	$ 2,013	14%
Interest income	16	56	(40)	(71)%
Total revenue	15,984	14,011	1,973	14%
Expenses:				
Electronic payment processing costs	13,072	11,287	1,785	16%
Salaries and benefits	979	993	(14)	(1)%
Professional fees	49	58	(9)	(16)%
Depreciation and amortization	558	519	39	8%
Other general and administrative costs	212	237	(25)	(11)%
Total expenses	14,870	13,094	1,776	14%
Income from continuing operations before (provision) benefit for income taxes and discontinued operations	$ 1,114	$ 917	$ 197	21%

Three Months Ending September 30, 2008 and 2007

Payment processing revenues increased $1,973,000 or 14% between periods. Acquired portfolios contributed approximately 1% of the period over period gain, primarily from acquiring two significant merchant portfolios between periods. The remaining 13% increase reflects organic revenue growth principally derived from an increase in the average number of active processing merchants, year over year of 14% to 7,525 active merchants at September 30, 2008, partially offset by a decrease of less than 1% in the average monthly processing volume per active merchant. The decrease in the average monthly processing volume per active merchant is partially the result of the addition of new merchants in 2008 whose average monthly sales volumes are less than the average monthly sales volume in the merchant portfolio in the same period in 2007.

Expenses increased $1,776,000 or 14% between periods. During the third quarter of 2007, the Company recorded a provision for charge back losses relating to one merchant totaling $300,000. Electronic payment processing costs increased $1,785,000 or 16% between years with 2% of the increase resulting from acquired portfolios. Organic merchant processing costs, excluding residual payments, increased 12% between years. The remaining increase in electronic payment processing costs of 2% is due to the effect of an increase in residual payments to third-party independent sales agencies and representatives. The increase in such residual payments reflects both higher residual percentage payments to select third-party sales referral sources in order to provide for additional incentives to their sales forces for merchant referrals and the growth of such third-party sales on a sales mix basis. During the third quarter of 2007, the Company recorded a provision for charge back losses relating to one merchant totaling $300,000. If for comparison purposes this charge back loss is eliminated from the 2007 period electronic payment processing costs, the margin of revenues less electronic payment processing costs declined approximately 3% from 21% in 2007 to 18% in 2008. The decline in such margin is attributable to a combination of a lower rate of margin contribution of acquisitions, higher residual expenses and competitive pricing pressures adversely affecting revenues derived from certain merchants. Excluding depreciation and amortization, all other costs decreased 4% between years as the result of cost savings realized through a consolidation of sales offices. Depreciation and amortization costs increased $39,000 due to the acquisition of merchant portfolios between years.

Table of Contents

(In thousands):	Nine months ended September 30: 2008	2007	$ Change	% Change
Revenue:				
Electronic payment processing	$ 47,070	$ 39,499	$ 7,571	19%
Interest income	64	139	(75)	(54)%
Total revenue	47,134	39,638	7,496	19%
Expenses:				
Electronic payment processing costs	38,221	31,637	6,584	21%
Salaries and benefits	3,021	2,879	142	5%
Professional fees	201	168	33	20%
Depreciation and amortization	1,679	1,409	270	19%
Other general and administrative costs	651	758	(107)	(14)%
Total expenses	43,773	36,851	6,922	19%
Income from continuing operations before (provision) benefit for income taxes and discontinued operations	$ 3,361	$ 2,787	$ 574	21%

Nine Months Ending September 30, 2008 and 2007

Payment processing revenues increased $7,496,000 or 19% between periods. Acquired portfolios contributed approximately 3% of the period over period gain as the result of acquiring two significant merchant portfolios between periods. The remaining 16% increase reflects organic revenue growth principally derived from an increase in the number of average active processing merchants between years of 12% to 7,525 active merchants at September 30, 2008, with the remainder of the increase due to an increase in the average monthly processing volume per active merchant. The increase in the average monthly processing volume per active merchant reflects a combination of growth in sales volume from existing merchants as well as the effect of the addition during the first half of 2007 of several higher than average processing volume merchants.

Expenses increased $6,922,000 or 19% between periods. During the nine months ended September 30, 2007, the Company recorded a provision for charge back losses relating to one merchant totaling $300,000. Electronic payment processing costs increased $6,584,000 or 21% between years with 3% of the increase resulting from acquired portfolios. Organic merchant processing costs, excluding residual payments, increased 16% between years. The remaining increase in electronic payment processing costs of 2% is due to the effect of an increase in residual payments to third-party independent sales agencies and representatives. The increase in such residual payments reflects both higher residual percentage payments to select third-party sales referral sources in order to provide for additional incentives to their sales forces for merchant referrals and the growth of such third-party sales on a sales mix basis. During the third quarter of 2007, the Company recorded a provision for charge back losses relating to one merchant totaling $300,000. If for comparison purposes this charge back loss is eliminated from the 2007 period electronic payment processing costs, the margin of revenues less electronic payment processing costs declined approximately 2% from 21% in 2007 to 19% in 2008. The decline in such margin is attributable to a combination of a lower rate of margin contribution of acquisitions, higher residual expenses and competitive pricing pressures adversely affecting revenues derived from certain merchants. Excluding depreciation and amortization, all other costs increased 2% between years as the result of an increase in allocated costs relating to corporate level sales staffing partially offset by cost savings realized through a consolidation of sales offices between periods. Depreciation and amortization increased by $270,000 due to the acquisition of merchant portfolios between years.

Table of Contents

Web Hosting

(In thousands):	Three months ended September 30: 2008	2007	$ Change	% Change
Revenue:				
Web hosting	$ 4,586	$ 4,163	$ 423	10%
Interest income	4	10	(6)	(60)%
Other income				
Total revenue	4,590	4,173	417	10%
Expenses:				
Salaries and benefits	1,183	1,055	128	12%
Interest	15	165	(150)	(91)%
Professional fees	27	26	1	4%
Depreciation and amortization	808	759	49	6%
Other general and administrative costs	1,659	1,851	(192)	(10)%
Total expenses	3,692	3,856	(164)	(4)%
Income from continuing operations before (provision) benefit for income taxes and discontinued operations	$ 898	$ 317	$ 581	183%

Three months ended September 30, 2008 and 2007:

Revenue is derived primarily from monthly recurring fees from hosting dedicated and shared websites. Revenue between periods increased $417,000, or 10%, to $4,590,000 in 2008 principally due to organic growth in the number of hosted websites. CrystalTech combined service and plan enhancements with various sales promotions, including free setup fees and/or free additional months of service for new customers who prepay for a period of time ranging from two to 12 months, to help drive growth in sites and revenue. The growth in the shared segment has slowed due to market conditions, increased competition, a deliberate price increase by the hosting division to improve profitability of the lowest cost plan and technology releases by Microsoft allowing for high-end shared users to move to lower end dedicated virtual plans.

The increase in revenue reflects an increase in the quarterly number of websites by 5,547 in the third quarter 2008 as compared to the third quarter 2007, or 9%, to 70,257 from 64,710. The average number of dedicated websites, which generate a higher monthly fee versus shared websites, increased by 443 between periods, or 22%, to an average of 2,495 per month from an average of 2,052 per month in the third quarter 2007. The average number of shared websites increased 5,104, or 8%, to an average of 67,762 per month in the third quarter 2008, from an average of 62,658 per month in the third quarter 2007.

The $164,000 decrease in expenses between periods primarily reflects the $150,000 decrease in interest expense and the $192,000 decrease in other general and administrative costs offset by the $128,000 increase in salaries and benefits. The decrease in interest expenses was a result of CrystalTech having fully paid their outstanding note payable to TICC in the third quarter 2007, which caused the 2007 interest expense to be burdened by a non-recurring charge associated with the write-off of the remaining $135,000 deferred financing costs relating to the TICC note. In the third quarter 2007, CrystalTech moved to a larger data center location with greater capacity to support its growing business; during the course of the construction of the new facility and the move CrystalTech operated both in its old and new facilities. The $192,000 decrease in other general and administrative costs between the periods primarily reflects the elimination of approximately $225,000 of expenses for temporary datacenter space and rent on the previous datacenter location and their related $75,000 in telephone and internet expense offsetting the costs of the new space. The new space should be sufficient to house growth beyond 2009. Offsetting the decreases in other general and administrative costs are a $49,000 increase in marketing expenses, a $16,000 increase in domain costs, and a $26,000

Table of Contents

increase in credit card processing costs. Salaries and benefits increased $128,000 or 12%, at a slightly higher rate than the revenue growth of 10% due to the addition of sales, marketing and customer personnel to existing staff. Due to current cost cutting initiatives of the Company and after reevaluating current staffing needs in line with the current growth trend, the Company believes that salaries and benefits should remain fairly stable into 2009. The $49,000 increase in depreciation and amortization was primarily due to capital expenditures between periods of approximately $2,619,000 for additional website hosting servers and the acquisition of website software. CrystalTech expects the growth in total expenses to remain comparable to its forecasted increase in revenues for the remainder of the year.

Income before benefit for income taxes increased $581,000 in the third quarter 2008 compared to the third quarter 2007, principally because of the growth in revenues and the decrease in expenses, thereby increasing operating margins. The period over period reduction in expenses primarily reflects the elimination of the duplicative rent, electricity and communications costs incurred in the third quarter 2007 while transitioning to the new data center.

	Nine months ended September 30:			
(In thousands):	**2008**	**2007**	**$ Change**	**% Change**
Revenue:				
Web hosting	$ 13,361	$ 11,982	$ 1,379	12%
Interest income	12	25	(13)	(52)%
Other income		4	(4)	(100)%
Total revenue	13,373	12,011	1,362	11%
Expenses:				
Salaries and benefits	3,596	3,069	527	17%
Interest	45	317	(272)	(86)%
Professional fees	81	76	5	7%
Depreciation and amortization	2,441	2,223	218	10%
Other general and administrative costs	4,961	4,176	785	19%
Total expenses	11,124	9,861	1,263	13%
Income from continuing operations before (provision) benefit for income taxes and discontinued operations	$ 2,249	$ 2,150	$ 99	5%

Nine months ended September 30, 2008 and 2007:

Revenue is derived primarily from monthly recurring fees from hosting dedicated and shared websites. Revenue between periods increased $1,362,000, or 11%, to $13,373,000 in 2008 due to organic growth of hosted websites. CrystalTech combined service and plan enhancements with various sales promotions, including free setup fees and/or free additional months of service for new customers who prepay for a period of time ranging from two to 12 months, to help drive growth in sites and revenue. The growth in the shared segment has slowed due to market conditions, increased competition, a deliberate price increase by the hosting division to improve profitability of the lowest cost plan and technology releases by Microsoft allowing for high end shared users to move to lower-end dedicated virtual plans.

The increase in revenue reflects an increase in the average number of total websites by 6,688 in 2008 as compared to 2007, or 11%, to 69,147 from 62,459. The average number of dedicated websites, which generate a higher monthly fee versus shared websites, increased by 430 between periods, or 22%, to an average of 2,393 per month from an average of 1,963 per month in the first nine months of 2007. The average number of shared websites increased 6,259, or 10%, to an average of 66,755 per month in the first nine months of 2008, from an average of 60,496 per month in the first nine months of 2007.

The majority of the $1,263,000 increase in expenses between periods reflects an increase in other general and administrative costs of $785,000, an increase in salaries and benefits of $527,000, and an increase in depreciation and amortization of $218,000, offset partially by a decrease in interest expense of $272,000. The increase in other general and administrative costs was primarily due to a $482,000 increase in rent and utilities reflecting CrystalTech s move to a larger datacenter location in 2007 with greater capacity to support its growing business. The Company believes that the new space should be sufficient to house

Table of Contents

growth beyond 2009. The increase in other general and administrative expenses included a $65,000 increase in additional software licenses required for additional servers, a $63,000 increase in marketing costs, a $72,000 increase in credit card processing costs and a $103,000 increase in general office and other miscellaneous costs, all in line with the growth in websites, offset partially by a $15,000 decrease in telephone and internet costs. Salaries and benefits increased $527,000, at a slightly higher rate than revenue growth, due to the addition of sales, marketing and customer service personnel to existing staff from the fourth quarter of 2007 into the first six months of 2008. The increase in salaries and benefits during this time frame was in anticipation of higher growth in sales than actually experienced. In line with the current growth trend and the cost cutting initiatives of the Company, management revised its staffing needs into the future and the Company believes that salaries and benefits should remain fairly stable into 2009. The $218,000 increase in depreciation and amortization was primarily due to capital expenditures between periods of approximately $2,619,000 for additional website hosting servers and the acquisition of website software. The increase in operating expenses was offset, in part, by a $272,000 decrease in interest expense due to lower borrowings during 2008 and the repayment of the TICC note payable in the third quarter of 2007 which caused the 2007 interest expense to be burdened by a non-recurring charge associated with the write-off of the remaining $135,000 deferred financing costs relating to the TICC note. CrystalTech expects the growth in total expenses to remain comparable to its forecasted increase in revenues for the remainder of the year.

For the first nine months of 2008 compared to the same period in 2007 expenses grew faster than revenues primarily due to the added rent and electricity expense for the new data center that came on line in the third quarter of 2007 and the increase in salaries and benefits in the first half of 2008. Income before (provision) benefit for income taxes increased $99,000 period over period principally because the revenues became sufficient to exceed these new costs. As more of the new data center s capacity is utilized, profits and margins should continue to improve.

Small Business Finance

	Three months ended September 30:			
(In thousands):	**2008**	**2007**	**$ Change**	**% Change**
Revenue:				
Premium on loan sales	$ (5)	$ 684	$ (689)	(101)%
Servicing fee	438	512	(74)	(14)%
Interest income	611	821	(210)	(26)%
Management fees	146	146		
Other income	457	561	(104)	(19)%
Total revenue	1,647	2,724	(1,077)	(40)%
Expenses:				
Salaries and benefits	918	1,086	(168)	(15)%
Interest	483	578	(95)	(16)%
Management fees	115	115		
Professional fees	8	37	(29)	(78)%
Depreciation and amortization	277	301	(24)	(8)%
Provision for loan losses	672	235	437	186%
Other general and administrative costs	668	534	134	25%
Total expenses	3,141	2,886	255	9%
Loss from continuing operations before (provision) benefit for income taxes and discontinued operations	$ (1,494)	$ (162)	$ (1,332)	(822)%

Three months ended September 30, 2008 and 2007:

Revenue is derived primarily from premium on loan sales generated by the sale of the guaranteed and unguaranteed portions of SBA loans, interest income on SBA loans held for investment, 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 Newtek Business Credit (NBC). Most SBA loans originated

Table of Contents

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 decrease in premium on loan sales resulted from management s decision to curtail the sale of the guaranteed portions of loans until credit markets stabilize and pricing returns to more favorable terms. In the third quarter, premiums on guaranteed portions declined precipitously reflecting the extraordinary rise in LIBOR, the interest rate on which buyers price their purchases, against the decline in the Prime rate, the interest rate SBA loans are set to. For a period, LIBOR exceeded Prime. The decision not to sell increased the balance of the Loans held for sale at September 30, 2008 to $6,116,000 as compared to a balance of $1,351,000 at September 30, 2007. In the three months ended September 30, 2008 the Company sold five guaranteed loans, aggregating $493,000 compared to 37 loans sold aggregating $9,714,000 in the same period for the prior year. According to the SBA 1086 guidelines, and in accordance with the Terms and Conditions of the Trade Advice in connection with selling the guaranteed portion of loans originated, if the borrower prepays in excess of 20% of the guaranteed portion of the loan or if the Borrower defaults on any scheduled note payment date within 90 days of settlement date, the Company is obligated to return any unamortized premium received for the guaranteed portion of the loan. In the three months ended September 30, 2008 NSBF refunded $19,000 of premium which exceeded the amount of premium received on the five sold loans discussed above. Should the pricing remain at current levels or continue to decline it will continue to adversely affect revenues and the segment s performance in the future.

The decrease in servicing fee income related to SBA loans was attributable to a decrease in the NSBF servicing portfolio quarter over quarter and to a lesser extent a decline in the servicing rate. The average NSBF servicing portfolio for the quarter ended September 30, 2008 was $126,024,000 compared with $133,938,000 for the quarter ended September 30, 2007. Beginning the third quarter of 2007, NSBF experienced a reduction in the servicing fee retained on the newly originated guaranteed portion of SBA loans sold. While the average for both quarters remained constant at 1.00%, this rate will continue to negatively impact servicing fee income in the future as the 1.00% servicing from new loans continues to replace higher servicing rates from older loans that pay down. This decrease was also attributable to a reduction in income associated with the servicing of an SBA portfolio for a savings bank in New York due to the reduction in that portfolio. In the three months ended September 30, 2008, NSBF recognized $40,000 in external servicing income as compared to $54,000 in the three months ended September 30, 2007.

While the average outstanding portfolio increased from $32,889,000 in the three months ended September 30, 2007 to $34,706,000 in the three months ended September 30, 2008, interest income decreased by $210,000 due to a decrease in the average interest rate being charged to borrowers from 11.05% to 7.29% due to a reduction in the prime rate in which SBA loans are tied to.

Other income decreased by $104,000 due primarily to a decrease in revenue earned by Newtek Business Credit. For the three months ended September 30, 2008, NBC had revenue of $336,000 and purchased $4,547,000 of receivables from an average customer base of 34 compared to revenue of $412,000 on $5,065,000 of receivables purchases with an average customer base of 41 for the three months ended September 30, 2007.

The provision for loan losses increased by $437,000 to $672,000 for the three months ended September 30, 2008 from $235,000 for the three months ended September 30, 2007. This increase was a result of an increase in net charge-offs from $1,000 for the three months ended September 30, 2007 to $379,000 for the three months ended September 30, 2008 as well as an increase in the average non-performing portfolio from $5,581,000 for the three months ended September 30, 2007 to $5,779,000 for the three months ended September 30, 2008. This increase in non-performing loans is attributable to the slowing economy as well as the portfolio being more seasoned. As a result higher non-performing percentages are expected versus the earlier years. Consideration in arriving at the provision for loan loss included past and current loss experience, current portfolio composition and the evaluation of real estate collateral as well as current economic conditions.

Salaries and benefits decreased by $168,000 due primarily to the restructuring of NSBF s bonus program. Based on current business conditions and the decision to reduce loan originations, NSBF has reduced staff at the time of the filing of this report.

Professional fees for the three months ended September 30, 2008 decreased by $29,000 primarily due to a reduction in NSBF and NBC contingent liabilities as a result of favorable settlements, which was offset by an increase in audit related and consulting expenses.

Table of Contents

After deducting the amortization of deferred financing costs associated with the lines of credit held by NSBF and NBC of $131,000 for the three months ended September 30, 2007 and $131,000 for the three months ended September 30, 2008, interest expense decreased from $447,000 to $352,000 for the same periods, respectively. This decrease was primarily attributable to a decrease in the prime lending rate on which the financing costs are based from an average rate of 8.18% to an average rate of 5.44% quarter over quarter, offset by an increase in the average amount borrowed. For the three months ended September 30, 2008 the average amount borrowed under the GE facility was $22,662,000 as compared to $16,961,000 during the same three month period in 2007. This increase was directly attributable to the decision to not sell loans under the current market environment.

The increase in other general and administrative costs is attributable primarily to additional expense related to Newtek obtaining insurance coverage for the collateral securing a loan when the borrower s policy naming Newtek as loss payee is cancelled for non-payment, as well as an increase in write-down s on the value of Real Estate Owned (REO). Due to the current downward trend in real estate values, the Company wrote-down the value of real estate by $103,000 in the three months ended September 30, 2008 as compared with a loss of $33,000 taken on the sale of REO during the three months ended September 30, 2007. Additionally, as a result of deterioration of credit quality on two NBC clients, a specific reserve of $39,000 was established during the three months ended September 30, 2008 as compared with no reserve during the same period in 2007.

As of September 30, 2008, NSBF failed to maintain the minimum Senior Charge Coverage Ratio (SCCR) specified in the GE line of Credit and notified GE of the occurrence of an Event of Default under the GE line of credit. Please see Liquidity and Capital Resources below for a discussion of this occurrence.

	Nine months ended September 30:			
(In thousands):	**2008**	**2007**	**$ Change**	**% Change**
Revenue:				
Premium on loan sales	$ 472	$ 2,198	$ (1,726)	(79)%
Servicing fee	1,360	1,452	(92)	(6)%
Interest income	1,955	2,778	(823)	(30)%
Management fees	439	439		
Other income	1,366	2,100	(734)	(35)%
Total revenue	5,592	8,967	(3,375)	(38)%
Expenses:				
Salaries and benefits	3,379	3,414	(35)	(1)%
Interest	1,439	1,862	(423)	(23)%
Management fees	345	345		
Professional fees	228	143	85	59%
Depreciation and amortization	863	886	(23)	(3)%
Provision for loan losses	1,528	607	921	152%
Other general and administrative costs	1,597	1,974	(377)	(19)%
Total expenses	9,379	9,231	148	2%
Loss from continuing operations before (provision) benefit for income taxes and discontinued operations	$ (3,787)	$ (264)	$ (3,523)	(1,334)%

Nine months ended September 30, 2008 and 2007:

Revenue is derived primarily from premium on loan sales generated by the sale of the guaranteed and unguaranteed portions of SBA loans, interest income on SBA loans held for investment, 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.

Premium on loan sales related to SBA loans decreased by $1,726,000 to $472,000 for the nine months ended September 30, 2008 from $2,198,000 for the nine month period ended September 30, 2007. The decrease in premium on loan sales resulted from a reduction in loan originations during 2008 directly attributable to the adverse conditions in the current credit environment as well as price deterioration in the SBA secondary market. In the third quarter, premiums on guaranteed portions declined precipitously reflecting the extraordinary rise in LIBOR, the interest rate on which buyers price their purchases, against the decline in the Prime rate, the interest rate SBA loans are set to. For a period, LIBOR exceeded Prime. As a result of both of these factors, management has taken a more conservative approach in underwriting loans and has curtailed the sale of loans until the markets have stabilized and pricing returns to more favorable terms, both of which has resulted in a material impact to income recognized. A direct result of the decision to not sell loans is the increase in the loans held for sale balance period over period. At September 30, 2008, the balance of loans held for sale was $6,116,000 as compared to a balance of $1,351,000 at September 30, 2007. In the nine months ended September 30, 2008, the Company sold 40 guaranteed loans, aggregating $10,311,000 compared to 139 loans sold aggregating $34,277,000 in the same period for the prior year. The decrease in premium on loan sales was also affected by the percentage of premium recognized on the sales; beginning in the third quarter of 2007, NSBF experienced a material reduction in the pricing of the premium on the guaranteed portion of SBA loans due to market conditions. The Company recognized an average premium on loan sales of 107.9% for the first nine months of 2008 compared with an average of 109.4% for the same period in 2007; brokers quoted prices of 102% to 104% for guaranteed portions at the end of the third quarter of 2008.

The decrease in premium on loan sales was also attributable to the significant reduction in market demand for the unguaranteed portion of SBA loans or loans classified as held for investment. The Company sold $1,857,000 of loans previously classified as held for investment, for aggregate proceeds of $1,950,000 during the nine months ended September 30, 2007. The carrying value above the amounts sold, or $93,000, was recorded as premium on loan sales. Also, in connection with this sale and included in premium on loan sales was an additional $133,000, representing the allocated portion of the remaining discount recorded at the time of loan origination, for total premium recognized of $226,000. There were no corresponding sales during the nine months ended September 30, 2008.

Servicing fee income related to SBA loans decreased by $92,000 from $1,452,000 for the nine months ended September 30, 2007 to $1,360,000 for the nine month period ended September 30, 2008. This decrease was attributable to the decrease of the NSBF servicing portfolio year over year. The Company s average portfolio on which servicing fee income is earned was $128,716,000 for the nine months ended September 30, 2008 compared with $134,615,000 for the corresponding prior nine month period. Over the same period, NSBF experienced a reduction in the servicing fee retained on the newly originated guaranteed portion of SBA loans sold from an average of 1.14% for the first nine months of 2007 to an average of 1.00%, the minimum allowed by the SBA, for the same period in 2008. This reduction in servicing fee percentages will continue to negatively impact servicing fee income in the future at current portfolio levels.

Interest income decreased by $823,000 due to a decrease in the average outstanding portfolio from $35,596,000 in the first nine months of 2007 to $33,243,000 in the first nine months of 2008 as well as a decrease in the average interest rate being charged to borrowers from 8.23% to 5.43% as a direct result of a decrease in the prime rate in which SBA loans are tied to.

Other income decreased by $734,000 to $1,366,000 due to a decrease in revenue earned by NBC. For the nine months ended September 30, 2008, NBC had revenue of $975,000 and purchased $11,737,000 of receivables from an average customer base of 33 compared to revenue of $1,435,000 on $16,462,000 of receivables purchases with an average customer base of 45 for the nine months ended September 30, 2007. Additionally, NSBF recorded a $161,000 recovery that was charged off several years ago, and an additional $59,000 of income recognized in connection with the recovery of expenses associated with the sale of OREO properties, both of which were recorded during the nine months ended September 30, 2007.

Salaries and benefits decreased by $35,000 due primarily to the restructuring of NSBF s bonus program. Based on current business conditions and the decision to reduce loan originations, NSBF has reduced staff at the time of the filing of this report.

Professional fees for the nine months ended September 30, 2008 increased by $85,000 primarily due to an increase in audit related and consulting expenses, offset by a reduction in NSBF and NBC contingent liabilities as a result of favorable settlements.

Table of Contents

After deducting the amortization of deferred financing costs associated with the lines of credit held by NSBF and NBC of $378,000 for the nine months ended September 30, 2007 and $393,000 for the nine months ended September 30, 2008, interest expense decreased from $1,484,000 to $1,046,000 for the same periods, respectively. This decrease was attributable to a decrease in the prime lending rate on which the financing costs are based, from 8.23% to an average rate of 5.43% for the comparative periods, offset by an increase in the average amount borrowed. For the nine months ended September 30, 2008 the average amount borrowed under the GE facility was $20,226,000 as compared to $19,151,000 during the same three month period in 2007.

The provision for loan losses increased by $921,000 to $1,528,000 for the nine months ended September 30, 2008 from $607,000 for the corresponding prior period. This was primarily a result of an increase in net charge-offs at NSBF from $395,000 for the nine months ended September 30, 2007 to $984,000 for the nine months ended September 30, 2008 as well as an increase in the average non-performing portfolio from $5,656,000 for the nine months ended September 30, 2007 to $5,935,000 for the nine months ended September 30, 2008. This increase in nonperforming loans is attributable to the slowing economy as well as the portfolio being more seasoned and as a result higher non-performing percentages are expected as compared with earlier years. Consideration in arriving at the provision for loan loss included past and current loss experience, current portfolio composition and the evaluation of real estate collateral as well as current economic conditions.

The decrease in other general and administrative costs is attributable to NSBF recording a recovery of $120,000 in the servicing asset valuation allowance as a result of an increase to the fair market value of certain servicing rights for the nine months ending September 30, 2008. This increase is attributable to a reduction in loan prepayment rates that off-set an increase in default rate and the discount rate used to calculate the servicing asset fair market value: the servicing portfolio is expected to last longer and therefore pay more servicing fees over its life. The servicing asset will continue to be examined periodically, and may fluctuate in future periods based on loan performance and interest rates. Additionally, NSBF recognized a loss on foreclosure and the sale of REO of $279,000 in the nine month period ending September 30, 2007 as compared with a net loss of $93,000 during the same period in 2008. Office related expenses decreased during the nine months ended September 30, 2008 as compared to the same period in 2007. Additional office related expenses were incurred during the first three months of 2007 associated with the Company s move. Additionally, significant cost savings measures were implemented at NBC throughout the latter half of 2007 and 2008. Such measures resulted in a reduction in general and administrative costs period over period of $144,000, offset by an increase in the accounts receivable reserve at NBC by $87,000 to $92,000 for the nine months ended September 30, 2008 from $5,000 for the corresponding period. This increase was attributable to the credit quality of three clients decreasing period over period.

The $3,523,000 increase in loss for the respective nine month periods primarily resulted from the reduction in premium and interest income, and increase in provision for loan losses at NSBF.

As of September 30, 2008, NSBF failed to maintain the minimum SCCR specified in the GE line of Credit and notified GE of the occurrence of an Event of Default under the GE line of credit. Please see Liquidity and Capital Resources below for a discussion of this occurrence.

Capcos

(In thousands):	Three months ended September 30: 2008	2007	$ Change	% Change
Revenue:				
Income from tax credits	$ 1,680	$ 1,337	$ 343	26%
Interest income	73	233	(160)	(69)%
Other income	2		2	100%
Total revenue	1,755	1,570	185	12%
Expenses:				
Salaries and benefits	5	5		
Interest	1,825	2,869	(1,044)	(37)%
Management fees	1,190	762	428	56%
Professional fees	105	162	(57)	(35)%
Depreciation and amortization	10	10		
Insurance		740	(740)	(100)%
Other general and administrative costs	66	52	14	27%

Total expenses	3,201	4,600	(1,399)	(30)%
Loss from continuing operations before fair market value adjustment, minority interest, (provision) benefit for income taxes and discontinued operations	(1,446)	(3,030)	1,584	52%
Net change in fair market value of Credits in lieu of cash and Notes payable in credits in lieu of cash	(74)		(74)	(100)%
Minority interest	109	117	(8)	(7)%
Loss from continuing operations before (provision) benefit for income taxes and discontinued operations	$ (1,411)	$ (2,913)	$ 1,502	(52)%

34

Table of Contents

Three months ending September 30, 2008 and 2007:

As described above and in Note 3 to the condensed consolidated financial statements, effective January 1, 2008, the Company adopted SFAS No. 157, Fair Value Measurements (SFAS 157) concurrent with its adoption of SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159) 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 liability associated with the Company s Capco notes that are reported within the Company s Capco segment. The table above reflects 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 three months ended September 30, 2008. In addition, the net change to the revalued financial assets and liability for the three months ended September 30, 2008 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 . The results for 2007 reflect the previous use of cost basis accounting.

Revenue is derived primarily from non-cash income from tax credits. The increase in third quarter 2008 revenue versus the third quarter 2007 reflects the effect of the higher interest rate used under fair value accounting than that previously used under cost basis accounting. The amount of future revenue will fluctuate with future interest rates. However, over future periods, 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. Management fees increased 56% or $428,000 for the three month period ended September 30, 2008 as compared to the three month period ended September 30, 2007 mainly due to the recovery of management fees from one Capco totaling approximately $220,000, and the reversal in the three month period ended September 30, 2007 of a previous quarter s accrued management fee for one capco. Management fees are expected to decline in the future as the Capcos mature and utilize their cash. For the three month period ended September 30, 2007 the amortization of the prepaid insurance purchased at the funding date was a major expense component. The revaluation of the notes payable in credits in lieu of cash on January 1, 2008 at a lower interest rate reflecting the risk in the security (as more fully described in Note 3 to the condensed consolidated financial statements) resulted in an increase in the liability and a commensurate substantial decrease in the interest expense compared to that under the cost basis of accounting. Because the liability now imbeds the value of the prepaid insurance, the prepaid insurance asset and its amortization have been substantially reduced.

For the three month period ended September 30, 2008, adoption of SFAS 159 resulted in a $2,053,000 reduction of the net non-cash loss (calculated by subtracting interest expense and amortization of prepaid insurance, from net change in fair market value of Credits in lieu of cash and Notes payable in credits in lieu of cash and income from tax credits) to $219,000 from that of $2,272,000 for the three months ended September 30, 2007, which was calculated on a cost basis.

Because the Company does not anticipate creating any new Capcos in the foreseeable future, we anticipate that our Capco segment will incur losses going forward through 2010. 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.

Table of Contents

(In thousands):	Nine months ended September 30: 2008	2007	$ Change	% Change
Revenue:				
Income from tax credits	$ 4,634	$ 3,958	$ 676	17%
Interest income	353	778	(425)	(55)%
Other income	6	190	(184)	(97)%
Total revenue	4,993	4,926	67	1%
Expenses:				
Salaries and benefits	6	29	(23)	(79)%
Interest	5,287	9,023	(3,736)	(41)%
Management fees	4,792	2,996	1,796	60%
Professional fees	485	485		
Depreciation and amortization	34	30	4	13%
Insurance	15	2,219	(2,204)	(99)%
Other general and administrative costs	225	224	1	
Total expenses	10,844	15,006	(4,162)	(28)%
Loss from continuing operations before fair market value adjustment, minority interest, (provision) benefit for income taxes and discontinued operations	(5,851)	(10,080)	4,229	42%
Net change in fair market value of Credits in lieu of cash and Notes payable in credits in lieu of cash	(13)		(13)	(100)%
Minority interest	334	295	39	13%
Loss from continuing operations before (provision) benefit for income taxes and discontinued operations	$ (5,530)	$ (9,785)	$ 4,255	43%

Nine months ending September 30, 2008 and 2007:

As described above and in Note 3 to the condensed consolidated financial statements, effective January 1, 2008, the Company adopted SFAS 157 concurrent with its adoption of SFAS 159 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 liability associated with the Company s Capco notes that are reported within the Company s Capco segment. The table above reflects 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 nine months ended September 30, 2008. In addition, the net change to the revalued financial assets and liability for the nine months ended September 30, 2008 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 . The results for 2007 reflect the previous use of cost basis accounting.

Revenue is derived primarily from non-cash income from tax credits. The increase in the nine months ended September 30, 2008 revenue versus the same period in 2007 reflects the effect of the higher interest rate used under fair value accounting than that previously used under cost basis accounting. The amount of future revenue will fluctuate with future interest rates. However, over future periods, 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. Management fees increased 60%, or $1,796,000, to $4,792,000 for the nine month period ended September 30, 2008 from $2,996,000 during the same period of 2007. The net increase was primarily due to the recovery of management fees from one Capco totaling approximately $1,858,000 during the nine months ended September 30, 2008, offset, in part, by a decline in management fees from one other Capco totaling $85,000 during the same period. Management fees are expected to decline in the future as the Capcos mature and utilize their cash. For the nine months ended September 30, 2007 the amortization of the prepaid insurance purchased at the funding date was a major expense component. The revaluation of the notes payable in credits in lieu of cash on January 1, 2008 at a lower interest rate reflecting the risk in the security (as more fully described in Note 3 to the condensed consolidated financial statements)

resulted in an increase in the liability and a commensurate substantial decrease in the interest expense compared to that under the cost basis of accounting. Because the liability now imbeds the value of the prepaid insurance, the prepaid insurance asset and its amortization have been substantially reduced.

For the nine months ended September 30, 2008, adoption of SFAS 159 resulted in a $6,603,000 reduction of the net non-cash loss (calculated by subtracting interest expense and amortization of prepaid insurance, from net change in fair market value of Credits in lieu of cash and Notes payable in credits in lieu of cash and income from tax credits) to $681,000 from that of $7,284,000 for the nine months ended September 30, 2007, which was calculated on a cost basis.

Because the Company does not anticipate creating any new Capcos in the foreseeable future, we anticipate that our Capco segment will incur losses going forward through 2010. 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.

All Other

	Three months ended September 30:			
(In thousands):	**2008**	**2007**	**$ Change**	**% Change**
Revenue:				
Interest income	$ 29	$ 144	$ (115)	(80)%
Insurance commissions	225	204	21	10%
Other income	148	358	(210)	59%
Total revenue	402	706	(304)	(43)%
Expenses:				
Salaries and benefits	576	591	(15)	(3)%
Professional fees	148	152	(4)	(3)%
Depreciation and amortization	23	32	(9)	(28)%
Other general and administrative costs	230	209	21	10%
Total expenses	977	984	(7)	(1)%
Loss from continuing operations before minority interest, (provision) benefit for income taxes and discontinued operations	(575)	(278)	(297)	(107)%
Minority interest		(26)	26	100%
Loss from continuing operations before (provision) benefit for income taxes and discontinued operations	$ (575)	$ (304)	$ (271)	(89)%

Three months ended September 30, 2008 and 2007:

The All Other segment includes revenues and expense primarily from qualified businesses that received investments made through the Company s Capcos which cannot be aggregated with other operating segments. As described above, certain entities previously consolidated with the All Other segment were transferred to the Small business finance segment. The table above reflects those changes for the three months ended September 30, 2008 and 2007.

Revenue decreased $304,000, or 43%, to $402,000 for the three month period ended September 30, 2008 as compared to $706,000 for the three month period ended September 30, 2007. The decrease is primarily due to a $210,000 reduction in other income, due to greater gains on sales of investment in 2007 versus the same period in 2008. Interest income decreased by $115,000 as a result of a decrease in cash and cash equivalents, as well as declining interest rates during the first nine months of 2008 as compared with the same period in 2007.

Table of Contents

Salaries and benefits decreased by $15,000, or 3% to $576,000 during the three month period ended September 30, 2008, as compared to $591,000 during the same period in 2007. The Company expects salaries and benefits to decline for the remainder of 2008 as the Company implements cost-cutting measures to bring expenses in-line with expected sales growth.

(In thousands):	Nine months ended September 30: 2008	2007	$ Change	% Change
Revenue:				
Interest income	$ 137	$ 525	$ (388)	(74)%
Insurance commissions	818	649	169	26%
Other income	753	1,920	(1,167)	(61)%
Total revenue	1,708	3,094	(1,386)	(45)%
Expenses:				
Salaries and benefits	2,246	1,542	704	46%
Professional fees	218	522	(304)	(58)%
Depreciation and amortization	71	161	(90)	(56)%
Other general and administrative costs	700	654	46	7%
Total expenses	3,235	2,879	356	12%
(Loss) income from continuing operations before minority interest, benefit for income taxes and discontinued operations	(1,527)	215	(1,742)	(810)%
Minority interest	1	(24)	25	104%
(Loss) income from continuing operations before (provision) benefit for income taxes and discontinued operations	$ (1,526)	$ 191	$ (1,717)	(899)%

Nine months ended September 30, 2008 and 2007:

The All Other segment includes revenues and expense primarily from qualified businesses that received investments made through the Company s Capcos which cannot be aggregated with other operating segments. As described above, certain entities previously consolidated with the All Other segment were transferred to the Small business finance segment. The table above reflects those changes for the nine months ended September 30, 2008 and 2007.

Revenue decreased $1,386,000, or 45% to $1,708,000 for the nine month period ended September 30, 2008, from $3,094,000 for the nine month period ended September 30, 2007. The decrease consists primarily of a $1,167,000 reduction in other income which was due to greater gains on the sale/recoveries of investments in qualified businesses totaling $217,000 for the nine months ended September 30, 2008 versus $1,400,000 for the same period in 2007. Interest income decreased by $388,000 as a result of a decrease in cash and cash equivalents as well as declining interest rates during the first nine months of 2008 as compared with the same period last year. Revenue at the insurance agency increased by $169,000 for the nine month period ended September 30, 2008 as compared to the nine month period ended September 30, 2007 due to growth in new business.

Salaries and benefits increased by $704,000, or 46% to $2,246,000 during the nine month period ended September 30, 2008, as compared to $1,542,000 during the same period in 2007, primarily due to the increased expense associated with additional customer service and sales staff for the insurance agency and Texas investments. The Company expects salaries and benefits to decline for the remainder of 2008 as the Company implements cost-cutting measures to bring expenses in-line with expected sales growth. Professional fees declined by $304,000, or 58% to $218,000 for the nine month period ended September 30, 2008 primarily due to the one-time reversal of approximately $150,000 in Newtek Insurance Agency broker commissions related to a book of business from prior to 2005.

Table of Contents

Corporate activities

(In thousands):	Three months ended September 30: 2008	2007	$ Change	% Change
Revenue:				
Management fees	$ 1,159	$ 731	$ 428	59%
Interest income	10	28	(18)	(64)%
Other income		1	(1)	(100)%
Total revenue	1,169	760	409	54%
Expenses:				
Salaries and benefits	1,390	2,046	(656)	(32)%
Interest	10	24	(14)	(58)%
Professional fees	295	334	(39)	(12)%
Depreciation and amortization	96	67	29	43%
Other general and administrative costs	601	776	(175)	(23)%
Total expenses	2,392	3,247	(855)	(26)%
Loss from continuing operations before (provision) benefit for income taxes and discontinued operations	$ (1,223)	$ (2,487)	$ 1,264	51%

Three months ended September 30, 2008 and 2007:

Revenue is derived primarily from management fees earned from the Capcos, which amount to 2.5% of certified capital. Management fee revenue increased 59%, or $428,000, to $1,159,000 for the three month period ended September 30, 2008 from $731,000 during the same period in 2007. The net increase was primarily due to the recovery of management fees from one Capco totaling approximately $220,000 during the three months ended September 30, 2008. Management fees 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.

Expenses declined $855,000, or 26%, in the three month period ended September 30, 2008 from the comparable period in 2007. For the third quarter 2008 compared to the same period 2007, salaries and benefits and other general and administrative costs have decreased $656,000 and $176,000 or 32% and 23%, respectively, reflecting the implementation of the Company s cost cutting initiatives. The Company intends to continue its cost cutting and operational efficiency efforts, primarily through personnel reductions, and expects salaries and benefits and other general and administrative costs to decline from its current level over the remainder of 2008. The Company does not believe that the reductions will impact the management of the Company s businesses.

(In thousands):	Nine months ended September 30: 2008	2007	$ Change	% Change
Revenue:				
Management fees	$ 4,698	$ 2,902	$ 1,796	62%
Interest income	26	83	(57)	(69)%
Other income	5	7	(2)	(29)%
Total revenue	4,729	2,992	1,737	58%
Expenses:				
Salaries and benefits	5,369	5,578	(209)	(4)%
Interest	44	93	(49)	(53)%
Professional fees	939	1,398	(459)	(33)%
Depreciation and amortization	260	187	73	39%
Other general and administrative costs	2,013	2,331	(318)	(14)%

Total expenses	8,625	9,587	(962)	(10)%
Loss from continuing operations before (provision) benefit for income taxes and discontinued operations	$ (3,896)	$ (6,595)	$ 2,699	41%

Table of Contents

Nine months ended September 30, 2008 and 2007:

Revenue is derived primarily from management fees earned from the Capcos, which amount to 2.5% of certified capital. Management fee revenue increased 62%, or $1,796,000, to $4,698,000 for the nine month period ended September 30, 2008 from $2,902,000 during the same period of 2007. The net increase was primarily due to the recovery of management fees from two Capcos totaling approximately $1,881,000 during the nine months ended September 30, 2008, offset by a decline in management fees from one other Capco totaling $85,000 during the same period. Management fees 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. Interest income declined 69%, or $57,000, to $26,000 for the nine month period ended September 30, 2008 from $83,000 during the same period of 2007 reflecting a reduction in interest income on cash investments due to a decrease in both the rate of interest received on the investments and the amount of cash on hand.

Expenses declined $962,000, or 10%, during the nine month period ended September 30, 2008 from the comparable period in 2007. As a result of the Company s cost cutting initiatives, salaries and benefits decreased $209,000 or 4%, professional fees decreased $459,000 or 33% and other general and administrative costs decreased $318,000 or 14% for the nine month period ended September 30, 2008, as compared to the same period 2007. Due to continuing cost cutting initiatives primarily through personnel reductions, the Company expects salaries and benefits and other general and administrative costs to decline from its current level over the remainder of 2008.

A summary of the Company s cash flows provided by (used in) operating activities by segment is as follows:

NEWTEK BUSINESS SERVICES INC. AND SUBSIDIARIES

Cash Flows from Operating Activities by Segment

For the nine months ended September 30, 2008

Business Services Segments									
Electronic Payment Processing	Web Hosting	Small Business Finance	All Other	Corporate Activities		Total Business Services Segments	CAPCO Segment	Eliminations	Total
$ 47,134	$ 13,373	$ 5,592	$ 1,708	$ 4,729	Operating revenues	$ 72,536	$ 4,993	$ (5,136)	$ 72,393
43,773	11,124	9,379	3,234	8,625	Operating expenses and minority interest	76,135	10,523	(5,136)	81,522
3,361	2,249	(3,787)	(1,526)	(3,896)	Income (loss) before (provision) benefit for income taxes	(3,599)	(5,530)		(9,129)
(1,154)	(954)	59	593	853	(Provision) benefit for income taxes	(603)	2,309		1,706
2,207	1,295	(3,728)	(933)	(3,043)	Net income (loss)	(4,202)	(3,221)		(7,423)
					Non-Cash:				
					Income from tax credits		(4,634)		(4,634)
1,679	2,441	863	71	260	Depreciation and amortization	5,314	34		5,348
			(93)		Gain on sale/recovery of investments	(93)			(93)
					Accretion of interest expense		5,287		5,287
1,090	900	(68)	(611)	(1,559)	Deferred income taxes	(248)	(2,314)		(2,562)
		1,528			Provision for loan losses	1,528			1,528
6	31	134	2	204	Other, net	377	(412)		(35)
					Changes in assets and liabilities:				
		(16,067)			SBA loans originated over proceeds from sale of SBA loans	(16,067)			(16,067)
		10,311			Proceeds from sale of SBA loans	10,311			10,311

(315)	368	(866)	95	256	Prepaid expenses, accounts receivable and other assets	(462)	50		(412)
(966)	193	(161)	468	(718)	Accounts payable, accrued expenses and deferred revenue	(1,184)	(181)		(1,365)
		149	64		Other net	213	15		228
$ 3,701	$ 5,228	$ (7,905)	$ (937)	$ (4,600)	Net cash provided by (used in) operations	$ (4,513)	$ (5,376)	$	$ (9,889)

40

Table of Contents

Our operating businesses are dependent on the health of the small- and medium-sized segments of the U.S. economy. The reduction in the availability of credit and a weakening economy is having a negative impact on consumer and commercial spending which could adversely impact our customers. This is also negatively impacting the value of commercial and residential real estate, which could adversely impact the loan portfolio of our Small Business Finance segment.

Critical Accounting Policies and Estimates:

The Company s significant accounting policies are described in Note 1 of the Notes to Condensed Consolidated Financial Statements included in its Form 10-K for the fiscal year ended December 31, 2007. A discussion of the Company s critical accounting policies, and the related estimates, are included in Management s Discussion and Analysis of Results of Operations and Financial Position in its Form 10-K for the fiscal year ended December 31, 2007. There have been no significant changes in the Company s existing accounting policies or estimates since its fiscal year ended December 31, 2007, other than the adoption of SFAS 157 and SFAS 159. See Notes 2 and 3 to these Unaudited Consolidated Financial Statements.

Liquidity and Capital Resources

(Dollars in thousands)

	For the Nine Months Ended September 30, 2008	2007
Net cash used in operating activities	$ (9,889)	$ (3,469)
Net cash (used in) provided by investing activities	(937)	9,555
Net cash provided by (used in) financing activities	3,279	(4,756)
Net (decrease) increase in cash and cash equivalents	(7,547)	1,330
Cash and cash equivalents, beginning of period	25,372	26,685
Cash and cash equivalents, end of period	$ 17,825	$ 28,015

Cash requirements and liquidity needs over the next twelve months are anticipated to be funded primarily through operating results and available cash and cash equivalents. We also have the capacity to borrow from our $10 million Capital One line of credit through CrystalTech. In our Small Business Finance segment, our SBA lending unit funds its cash requirements and liquidity needs through available cash and cash equivalents and utilizes the $50 million GE line of credit to originate and warehouse the guaranteed and unguaranteed portion of loans held by our SBA lending unit, and our receivables financing unit utilizes the $10 million Wells Fargo line of credit to purchase receivables. There are no cross covenants or collateralization under any of the above lending facilities. The availability of the lending facilities is subject to the compliance with certain covenants and in addition, for the GE and Wells Fargo lines, the amount of collateral and collateral requirements, as set forth in the agreements. The Company guarantees the lines of credit for the subsidiaries: Capital One for the amount borrowed, GE up to $15 million, and Wells Fargo up to $800,000. As of September 30, 2008, our unused sources of liquidity consisted of unrestricted cash and cash equivalents of $17,825,000, and with $10,000,000, $523,000 and $27,500 available through the Capital One, GE, and Wells Fargo lines of credit, respectively.

As of September 30, 2008, NSBF failed to maintain the minimum Senior Charge Coverage Ratio (SCCR) specified in the GE line of Credit and notified GE of the occurrence of an Event of Default under the agreement with GE (Event of Default). The shortfall in the SCCR resulted primarily from management s decision not to sell the guaranteed portions of loans in the secondary market. As a result of the reduction in the spread between LIBOR and the Prime rate that occurred in the third quarter with the dislocation of the credit markets, premiums on guaranteed portions of loans declined and remain substantially below those obtained by NSBF earlier in 2008. Management believes that the premium will improve as credit markets recover. Because NSBF derives liquidity and profits from selling guaranteed portions of its SBA 7a loan originations, the decision not to sell at this time has negatively impacted both. In addition, from time-to-time we may sell the unguaranteed portion of our loans. We do not depend on such sales to fund our operations; instead management relies on our credit facility to permit us to make loans. Currently the price for the unguaranteed portions has become less attractive and management has elected not to sell them.

We use the GE line of credit to originate and fund the guaranteed and unguaranteed portions of loans held by NSBF. As of November 4, 2008, we had approximately $28 million outstanding under the GE line of credit. GE has informed NSBF that it reserves all rights and remedies available to it under the GE line of credit in respect of the Event of Default. Following an Event of Default, GE has the option of terminating the GE line of credit as to new advances, modifying its terms or declaring all amounts outstanding under the GE line of credit to be immediately due and payable. To date, GE has taken no action to restrict NSBF from drawing further advances on the GE line of credit to meet commitments, but there can be no assurance that GE will continue to do so or that it will not take other actions as permitted by the GE line of credit agreement. If GE were to take some or all of the actions permitted under the GE line of credit in respect of the Event of Default, the impact on our SBA lending business and the Company may be materially negative. The lines from Wells Fargo and Capital One are unaffected by this issue.

We believe our loan loss reserves, which are evaluated monthly on a loan-by-loan basis, along with our collateral monitoring practices are adequate. While we are aware of the changing conditions occurring nationally in the residential real estate market, loans within the portfolio are typically repaid by the business cash flow and secured by business collateral and personal assets of the business owner and/or guarantors which may include residential real estate as supplemental collateral. We follow the SBA standard operating procedure with respect to obtaining collateral on our loans. This typically includes all business assets and frequently includes personal assets of the owners and/or guarantors.

Restricted cash totaling $9,704,000 which is primarily held in the Capcos, is used for paying management fees to the Corporate entity for the managing and operating of the Capcos, making qualified investments, to repay debt obligations and for the payment of income taxes.

Net cash flows used in operating activities decreased $7,812,000 to $(9,889,000) for the nine months ended September 30, 2008 compared to $(2,077,000) for the nine months ended September 30, 2007, primarily due to our Small business finance segment s operations. Loan sales declined for the nine months ended September 30, 2008 as compared to the same period last year by $12,916,000. This was offset by a decline in the amount of loan originations of $6,724,000 from period to period.

Net cash flows (used in) provided by investing activities primarily includes the purchase of fixed assets and customer accounts, activity regarding the unguaranteed portions of SBA loans, changes in restricted cash and activities involving investments in qualified businesses. Net cash flows (used in) provided by investing activities decreased by $7,134,000 to $(937,000) for the nine months ended September 30, 2008 compared to $6,197,000 for the nine months ended September 30, 2007. The decline was due primarily to greater returns from qualified investments in 2007 as compared to 2008, as well as qualified investments made during 2008 only. Proceeds from sales of an asset held for sale and U.S. Treasury Notes, and SBA loans sold held for investment, all of which occurred in 2007 only, accounted for $8,758,000 of the change.

Net cash flows provided by (used in) financing activities primarily includes repayments on notes payable (AI Credit, the proceeds of which were used to finance Capco activities; TICC, which were funds borrowed by CrystalTech Web Hosting, Inc., and paid off in full during 2006 and 2007), and the net borrowings (repayments) on bank notes payable to North Fork, Wells Fargo, and GE. Net cash flows provided (used in) by financing activities increased by $5,919,000 to $3,279,000 for the nine months ended September 30, 2008 from $(2,640,000) for the nine months ended September 30, 2007. The primary reason for the decline was the net cash provided by a $2,050,000 reduction in restricted cash in NBC for the nine months ended September 30, 2007 and a $4,980,000 change in net borrowings on bank notes payable to $4,226,000 during the nine month period ended September 30, 2008, from net repayments of $754,000 for the nine months ended September 30, 2007. The 2008 net borrowings consisted of NSBF borrowing a net $6,524,000 to fund operations and make loans, offset by Crystaltech repaying $2,500,000 on its line of credit. During the same period in 2007, NSBF had net borrowings of $1,000,000 to fund operations and make loans, while NBC repaid a net of $1,700,000 as a result of debt restructuring.

Table of Contents

Historically, Newtek has funded its operations through the issuance of notes to insurance companies through the Capco programs. We are not anticipating any cash flow from new Capco programs for the foreseeable future. We believe our cash flow generated by our operating companies, available borrowing capacity, existing cash and cash equivalents, and other investments should provide adequate funds for continuing operations and to fund principal and interest payments on our debt.

Item 3. Quantitative and Qualitative Disclosure about Market Risk.

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

Because the SBA lender borrows money to make loans and investments, our net operating income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. The Company had outstanding bank notes payable of approximately $26,291,000 at September 30, 2008. Interest rates on such notes are variable ranging between Prime plus 0.25%-2.0% or LIBOR plus 2.50%. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our interest income. In periods of decreasing interest rates, our revenue from interest income would decrease, which would reduce our net operating income. We have analyzed the potential impact of changes in interest rates on interest income net of interest expense. Assuming that the balance sheet were to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical immediate 1% change in interest rates would have the effect of a net increase (decrease) in assets by less than 1% as of September 30, 2008. Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not take into account potential changes in credit quality, size and composition of the assets on the balance sheet, and other business developments that could affect a net increase (decrease) in assets. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate.

In addition, we do not have significant exposure to changing interest rates on invested cash, which were approximately $27,529,000 and $38,320,000 at September 30, 2008 and December 31, 2007, respectively. The Company invests cash mainly in money market accounts and other investment-grade securities and does 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.

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief 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 and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 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 Securities 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. A controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls systems are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

Table of Contents

(b) Change in Internal Control over Financial Reporting

No change in our internal control over financial reporting occurred during the quarter ended September 30, 2008 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.

Table of Contents

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are not involved in any material pending litigation.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 4. Submission of Matters To a Vote of Security Holders

None.

Item 6. Exhibits

Exhibit No.	Description
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

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

	NEWTEK BUSINESS SERVICES, INC.
Date: November 13, 2008	By: /s/ Barry Sloane Barry Sloane Chairman of the Board, Chief Executive Officer and Secretary
Date: November 13, 2008	By: /s/ Seth A. Cohen Seth A. Cohen Chief Financial Officer and Treasurer