

NEWTEK BUSINESS SERVICES INC  
Form 10-Q  
August 14, 2007  
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## SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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### FORM 10-Q

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(Mark One)

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

For the quarterly period ended June 30, 2007

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

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## NEWTEK BUSINESS SERVICES, INC.

(Exact name of registrant as specified in its charter)

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

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

1440 Broadway, 17<sup>th</sup> floor, New York, NY  
(Address of principal executive offices)

10018  
(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  No

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

As of August 7, 2007, there were 36,770,500 of the Company's Common Shares issued and outstanding.

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**Table of Contents****Item 1. Financial Statements (Unaudited)****NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)****FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2007 AND 2006****(In Thousands, except for Per Share Data)**

	<b>Three Months ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Revenue:</b>				
Electronic payment processing	\$ 13,013	\$ 10,510	\$ 25,530	\$ 19,942
Web hosting	3,943	3,310	7,820	6,474
Interest income	1,546	1,923	3,038	3,336
Income from tax credits	1,320	2,022	2,621	3,280
Premium income	797	763	1,513	1,377
Servicing fee	496	487	940	986
Insurance commissions	207	188	445	432
Other income	2,089	223	3,313	745
<b>Total revenue</b>	<b>23,411</b>	<b>19,426</b>	<b>45,220</b>	<b>36,572</b>
<b>Expenses:</b>				
Electronic payment processing costs	9,654	7,555	18,624	14,462
Consulting, payroll and benefits	5,224	4,075	10,737	8,121
Interest	3,614	4,577	7,336	8,885
Professional fees	2,183	1,874	4,002	3,928
Depreciation and amortization	1,803	1,527	3,531	2,882
Insurance	873	840	1,686	1,703
Provision for loan losses	205	235	372	354
Other general and administrative costs	2,729	2,300	5,996	4,659
<b>Total expenses</b>	<b>26,285</b>	<b>22,983</b>	<b>52,284</b>	<b>44,994</b>
Loss from continuing operations before minority interest, benefit for income taxes, and discontinued operations	(2,874)	(3,557)	(7,064)	(8,422)
Minority interest	56	97	180	330
Loss from continuing operations before benefit for income taxes and discontinued operations	(2,818)	(3,460)	(6,884)	(8,092)
Benefit for income taxes	717	1,114	2,089	2,721
Loss from continuing operations before discontinued operations	(2,101)	(2,346)	(4,795)	(5,371)
Discontinued operations, net of taxes	(286)	59	(491)	356
<b>Net loss</b>	<b>\$ (2,387)</b>	<b>\$ (2,287)</b>	<b>\$ (5,286)</b>	<b>\$ (5,015)</b>

Weighted average common shares outstanding:

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Basic and diluted	35,868	34,696	35,720	34,765
Loss per share from continuing operations:				
Basic and diluted	\$ (0.06)	\$ (0.07)	\$ (0.13)	\$ (0.15)
(Loss) income per share from discontinued operations, net of taxes:				
Basic and diluted	(0.01)	(0.00)	(0.02)	0.01
Basic and diluted loss per share	\$ (0.07)	\$ (0.07)	\$ (0.15)	\$ (0.14)

See accompanying notes to these unaudited condensed consolidated financial statements

**Table of Contents****NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****JUNE 30, 2007 AND DECEMBER 31, 2006****(In Thousands, except for Per Share Data)**

	<b>June 30, 2007 (Unaudited)</b>	<b>December 31, 2006 (Note 1)</b>
<b><u>ASSETS</u></b>		
Cash and cash equivalents	\$ 28,015	\$ 26,685
Restricted cash	8,966	11,275
U.S. Treasury notes	2,950	5,016
Asset held for sale		1,530
Credits in lieu of cash	99,054	106,425
SBA loans held for investment (net of reserve for loan losses of \$2,598 and \$2,332, respectively)	25,998	27,746
Accounts receivable (net of allowance of \$352 and \$23, respectively)	5,301	1,568
SBA loans held for sale	2,363	1,786
Accrued interest receivable	517	519
Investments in qualified businesses - cost method investments	504	542
Investments in qualified businesses - held to maturity debt investments	1,919	5,301
Prepaid and structured insurance	16,118	17,497
Prepaid expenses and other assets (net of accumulated amortization of deferred financing costs of \$1,178 and \$832, respectively)	6,820	7,682
Servicing assets (net of accumulated amortization of \$2,561 and \$2,081, respectively)	3,016	2,991
Fixed assets (net of accumulated depreciation and amortization of \$5,336 and \$4,065, respectively)	4,706	4,458
Intangible assets (net of accumulated amortization of \$7,637 and \$5,919, respectively)	8,034	9,141
Goodwill	13,055	10,575
<b>Total assets</b>	<b>\$ 227,336</b>	<b>\$ 240,737</b>
<b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>		
<b>Liabilities:</b>		
Accounts payable and accrued expenses	\$ 10,242	\$ 8,509
Notes payable	5,964	10,651
Bank notes payable	16,696	16,391
Deferred revenue	2,379	2,761
Notes payable in credits in lieu of cash	82,400	86,332
Deferred tax liability	21,734	24,428
<b>Total liabilities</b>	<b>139,415</b>	<b>149,072</b>
<b>Minority interest</b>	<b>5,246</b>	<b>4,596</b>
<b>Commitments and contingencies</b>		
<b>Shareholders' equity:</b>		
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 35,910 and 35,479 not including 583 shares held in escrow and 473 shares held by affiliate)	718	710
Additional paid-in capital	55,858	54,949
Retained earnings	26,177	31,464

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Treasury stock, at cost (44 and 32 shares at June 30, 2007 and December 31, 2006, respectively)	(78)	(54)
<b>Total shareholders' equity</b>	<b>82,675</b>	<b>87,069</b>
Total liabilities and shareholders' equity	\$ 227,336	\$ 240,737

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 SIX MONTHS ENDED JUNE 30, 2007 AND 2006****(In Thousands)**

	<b>2007</b>	<b>2006</b>
Cash flows from operating activities:		
Net loss	\$ (5,286)	\$ (5,015)
Adjustments to reconcile net loss to net cash used in operating activities:		
Income from tax credits	(2,621)	(3,280)
Deferred income taxes	(2,695)	(2,435)
Depreciation and amortization	3,531	3,012
Capitalization of servicing asset	(504)	(428)
Gain on sale/recoveries of investments in qualified businesses	(1,032)	
Accretion of interest expense	6,082	6,663
Loss on redemption of U.S. Treasury notes	13	
Provision for loan losses	372	354
Accretion of interest income	(100)	(7)
Equity in earnings of investee	(177)	(98)
Loss on sale of other real estate owned	247	
Gain on sale of land and building		(308)
Gain on sale of asset held for sale	(198)	
Loss on disposal of fixed assets		25
Gain on sale of loans held for investment	(93)	(189)
Stock-based compensation	262	311
Amortization of deferred loan origination fees, net	(188)	(105)
Minority interest	272	(259)
Changes in assets and liabilities, net of the effect of business acquisitions:		
Originations of SBA loans held for sale	(14,284)	(16,417)
Proceeds from sale of SBA loans held for sale	13,707	14,326
Premium on repurchase of portfolio		44
Prepaid insurance	1,480	1,487
Prepaid expenses, accounts receivable, accrued interest receivable from bank and other assets	980	(532)
Restricted cash	(1,757)	
Accounts payable, accrued expenses and deferred revenue	(1,480)	456
Net cash used in operating activities	(3,469)	(2,395)
Cash flows from investing activities:		
Investments in qualified businesses		(6,250)
Return of investments in qualified businesses	1,370	6,304
Purchase of fixed assets	(1,659)	(1,392)
Purchase of customer merchant accounts	(166)	(2,531)
Cash addition from acquired interests	233	
Cash reduction from deconsolidation of acquired interests	(56)	
SBA loans originated for investment, net	(4,321)	(5,019)
Cash paid for repurchase of SBA loans		(1,214)
Proceeds from sale of SBA loans held for investment	1,950	4,173
Payments received on SBA loans	3,993	3,373
Proceeds from sale of land and building		1,300
Proceeds from sale of asset held for sale and insurance recoveries	1,572	



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Proceeds from sale/recoveries of investments in qualified businesses	492	
Change in restricted cash	4,066	1,812
Proceeds from sale of U.S. Treasury Notes, marketable securities and certificates of deposit	2,081	14,001
Other investments		(4)
Net cash provided by investing activities	9,555	14,553

**Table of Contents****NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)****FOR THE SIX MONTHS ENDED JUNE 30, 2007 AND 2006 (CONTINUED)**

	2007	2006
<b>Cash flows from financing activities:</b>		
Proceeds from notes payable	5,073	299
Repayments of notes payable	(8,766)	(9,414)
Change in restricted cash related to CDS financing	2,050	
Net (borrowings) proceeds on bank notes payable	(2,954)	722
Distributions to minority member	(597)	
Payments for deferred financing costs	(165)	
Purchase of treasury stock	(24)	
Net proceeds from option exercise	141	
Net proceeds from issuance of common stock and other	486	(267)
<b>Net cash used in financing activities</b>	<b>(4,756)</b>	<b>(8,660)</b>
Net increase in cash and cash equivalents	1,330	3,498
Cash and cash equivalents - beginning of period	26,685	23,940
Cash and cash equivalents - end of period	\$ 28,015	\$ 27,438
 <b>Supplemental disclosure of cash flow activities:</b>		
Reduction of credits in lieu of cash and notes payable in credits in lieu of cash balances due to delivery of tax credits to Certified Investors	\$ 9,991	\$ 9,993
Conversion of note payable to minority interest	\$ 1,000	\$
 <b>Additions to assets and liabilities as a result of consolidation of acquired interests:</b>		
Cash	\$ 233	\$
Accounts receivable	3,579	
Prepaid expenses and other assets	94	
Total assets	\$ 3,906	\$
Accounts payable and accrued expenses	\$ 3,127	\$
Notes payable	3,259	
Total liabilities	6,386	
Goodwill recognized	\$ 2,480	\$
 <b>Reduction of assets and liabilities as a result of deconsolidation of acquired interests:</b>		
Cash	\$ 56	\$
Accounts receivable	30	
Prepaid expenses and other assets	21	
Fixed assets, net	80	

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Total assets	\$	187	\$
Accounts payable and accrued expenses	\$	143	\$
Deferred revenue		2	
Notes payable		16	
Minority interest		26	
Total liabilities	\$	187	\$

See accompanying notes to these unaudited condensed consolidated financial statements

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

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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

Newtek Business Services, Inc. ( Newtek ) is a holding company for several wholly and majority-owned subsidiaries, including 15 certified capital companies which are referred to as Capcos, and several portfolio companies in which the Capcos own non-controlling or minority interests. Newtek is a direct distributor of business services, acting through its wholly and majority-owned subsidiaries, to the small and medium-sized business market.

The Company's principal business segments are:

**Electronic Payment Processing:** Marketing, credit card processing and check approval services.

**Web Hosting:** CrystalTech Web Hosting, Inc., which offers shared and dedicated web hosting and related services.

**SBA Lending:** 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.

**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:** 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.

The consolidated financial statements of Newtek Business Services, Inc., its subsidiaries and FIN 46 consolidated entities, (Financial Accounting Standards Board ( FASB ) issued Interpretation ( FIN ) No. 46R Consolidation of Variable Interest Entities ), (the Company or Newtek) included herein have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America and include all wholly and majority owned subsidiaries, and several portfolio companies in which the Capcos own non-controlling minority interest in, or those which Newtek is considered to be the primary beneficiary of (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 return to profitability, the losses will be restored to the Company prior to allocation of profits to minority interest holders.

The accompanying notes to condensed consolidated financial statements should be read in conjunction with Newtek's 2006 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 the financial statements prepared in accordance with accounting principles generally accepted in the United States. The results of operations for an interim period may not give a true indication of the results for the entire year.

All financial information included in the tables in the following footnotes are 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,

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allowance for loan losses, valuation of servicing assets, chargeback reserves and tax valuation allowances. Actual results could differ from those estimates.

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### *Revenue Recognition*

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

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

**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 June 30, 2007, as summarized earlier in this note, the Company had Capcos in seven states and the District of Columbia. Each 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 income from tax credits , with a corresponding asset called credits in lieu of cash , in the 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.

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.

**Web Hosting revenue:** Web Hosting revenues are primarily derived from monthly recurring services fees for the use of its 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.

**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 a third party and generally retains the unguaranteed principal portion in its own portfolio. A gain is recognized on these loans through collection on sale of a premium over

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the adjusted carrying value. Commencing on January 1, 2007, gain on sale of the guaranteed portion of the loans is recognized at the date of settlement, under the terms of Statement of Financial Accounting Standards ( 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 income in the condensed consolidated statements of operations. Prior to January 1, 2007, gain on sale of the guaranteed portion of loans was recognized under the provisions of SFAS No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities a replacement of FASB Statement No. 125.

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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 transferor (the unguaranteed portion of the loan) based on their relative fair values at the date of transfer. 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.

**Interest and Small Business Administration ( SBA ) Loan Fees SBA Loans:** Interest income on loans is recognized as earned. Loans are placed on nonaccrual 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 nonaccrual, 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 nonaccrual 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 investments. Revenue is recorded when there is pervasive evidence of an agreement, the related fees are fixed, the service, and or product, has been delivered, and the collection of the related receivable is assured.

### ***Restricted Cash***

Restricted cash includes cash collateral relating to a letter of credit; monies due on loan related remittances 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.

### ***Investments***

### **U.S. Treasury Notes and Marketable Securities**



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The Company accounts for U.S. Treasury notes and other marketable securities in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. The Company determines the appropriate classification of all marketable securities as held-to-maturity, available-for-sale or trading at the time of purchase. The Company invests excess cash not required for use in operations primarily in high credit quality securities that the Company believes bear minimal risk. These investments include

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money market funds and auction rate securities. Rates on these securities typically reset every 7 or 28 days. The underlying security of auction rate securities have a final maturity extending to fiscal 2038. The Company has not experienced any losses due to institutional failure or bankruptcy. In determining the cost basis, the Company accounts for the realized gains and losses on the sale of its available-for-sale securities, on both the specific identification and average cost methods. Realized gains and losses are included in other income (expense). As of June 30, 2007 all of the Company's investments in marketable securities were classified as available-for-sale and, as a result, were reported at fair value.

**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 consolidated financial statements. All significant inter-company accounts and transactions are eliminated, including returns of principal, dividends, interest received and investment redemptions. The results of operations and cash flows of a consolidated operating entity are included through the latest interim period in which the Company owned a greater than 50% direct or indirect voting interest, exercised control over the entity for the entire interim period or was otherwise designated as the primary beneficiary. Upon dilution of control below 50%, or upon occurrence of a triggering event requiring reconsideration as to the primary beneficiary of a variable interest entity, the accounting method is adjusted to the equity or cost method of accounting, as appropriate, for subsequent periods.

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

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

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 5 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 this will be counted towards the Capco's minimum investment benchmarks.

***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.

In November 2005, the FASB issued FASB Staff Position No. FAS 123R-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards." The Company has elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of share-based compensation pursuant to SFAS 123R. The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool related to the tax effects of employee share-based compensation, which is available to absorb tax deficiencies subsequent to the adoption of SFAS 123R.

As of June 30, 2007, the Company had two share-based compensation plans. The compensation cost that has been charged against income for those plans was \$52,000 and \$171,000, for the three and six months ended June 30, 2007, respectively, and is included in consulting, payroll and benefits in the accompanying condensed consolidated statements of operations. The total income tax benefit recognized in the consolidated

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statement of operations for share-based compensation arrangements was \$21,000 and \$68,000, for the three and six months ended June 30, 2007, respectively.

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A summary of stock option activity under the 2000 and 2003 Plans as of June 30, 2007 and changes during the period then ended is presented below:

	Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Term (in years)	Aggregate Intrinsic Value (in thousands)
<b>Stock Options</b>				
Outstanding December 31, 2006	1,738	\$ 3.18		
Granted				
Exercised	(90)	\$ 1.57		\$ 79,200
Cancelled	(241)	\$ 3.55		
Outstanding June 30, 2007	1,407	\$ 3.22	4.64	\$ 943,000
Exercisable June 30, 2007	1,357	\$ 3.27	4.76	\$ 943,000

There were no options granted during the six months ended June 30, 2007 and 2006.

A summary of the status of Newtek's non-vested restricted shares as of June 30, 2007 and changes during the period then ended is presented below:

	Number of Shares (in thousands)	Weighted Average Grant Date Fair Value
<b>Non-vested Restricted Shares</b>		
Non-vested at December 31, 2006	91	\$ 2.53
Granted	63	\$ 2.07
Vested	(53)	\$ 2.49
Forfeited	(1)	\$ 3.63
Non-vested at June 30, 2007	100	\$ 2.21

In the six months ended June 30, 2007, Newtek granted four employees an aggregate of 52,588 shares of restricted stock valued at \$105,000. Additionally, pursuant to the terms of the Company's directors' compensation program, but not pursuant to the two share-based compensation plans discussed above, the Company issued to its four independent directors a total of 24,147 unregistered common shares with a market valuation as of that date of \$46,000. The shares were issued in exchange for the services of the directors on the Board of Directors and its committees in reliance on Section 4(2) of the Securities Act of 1933, as amended. The grants vest between 3 and 28 months. Additionally, the Company granted an officer 10,121 shares, valued at \$25,000 which immediately vested. The fair market values of these grants were determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee. Upon vesting, the grantee will receive one common share for each restricted share vested.

As of June 30, 2007, there was \$149,000 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 year ending December 31, 2009.

**Fair value of financial instruments**

SFAS No. 107, Disclosures about Fair Value of Financial Instruments, requires the disclosure of the estimated fair values of financial instruments. Excluding property and equipment, substantially all of the Company's assets and liabilities are considered financial instruments as defined by SFAS No. 107. Fair value is defined as the price at which a financial instrument could be liquidated in an orderly manner over a reasonable time period under present market conditions. Fair value estimates are subjective in nature and are dependent on a number of significant assumptions associated with each instrument or group of similar instruments, including estimates of discount rates, risks associated with specific financial instruments, estimates of future cash flows and relevant available market information. Fair value information is supposed to represent estimates of the amounts at which financial instruments could be exchanged in current transactions between willing buyers and sellers engaging in exchange transactions. However, since there are no established trading markets for a significant portion of the Company's financial instruments, the Company's may not be able to settle their financial instruments immediately; as such, the fair values are not necessarily indicative of the amounts that could be realized through immediate settlements. In addition, the majority of the Company's financial instruments,

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such as loans receivable held for investment and bank notes payable, are held to maturity and are realized or paid according to the contractual agreements with the customers or counterparties.

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SFAS No. 107 requires that, where available, quoted market prices be used to estimate fair values. However, because of the nature of the Company's financial instruments, in many instances quoted market prices are not available. Accordingly, the Company has estimated fair values on the basis of other valuation techniques permitted by SFAS No. 107, such as discounting estimated future cash flows at rates commensurate with the risks involved or other acceptable methods. Fair values are required to be estimated without regard to any premium or discount that may result from concentrations of ownership of a financial instrument, possible income tax ramifications, or estimated transaction costs. Fair values are also estimated at a specific point in time and are based on interest rates and other assumptions at that date. As the assumptions underlying these estimates change, the fair values of financial instruments will change.

Because SFAS No. 107 permits many alternative calculation techniques and because numerous assumptions have been used to estimate the Company's fair values, reasonable comparisons of the Company's fair value information with other financial institutions' fair value information cannot necessarily be made.

The methods and assumptions used to estimate fair values are set forth in the following paragraphs for each major grouping of the Companies' financial instruments.

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

Cash and cash equivalents

Bank notes payable

Accrued interest receivable and payable

The carrying values of accounts payable and accrued expenses approximate fair value because of the short term maturity of these instruments. The carrying value of investments in qualified businesses, loans receivable, structured insurance product, notes and loans payable, credits in lieu of cash, and notes payable in credits in lieu of cash approximate fair value based on management's estimates.

***New Accounting Pronouncements***

The Company adopted FASB Statement of Financial Accounting Standards No. 156 (SFAS No. 156) Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140, on January 1, 2007. SFAS No. 156 requires the recognition of a servicing asset or servicing liability when entering into a servicing contract to service a financial asset and requires all separately recognized servicing assets and liabilities to be initially measured at fair value. Further SFAS No. 156 permits a choice of subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities between the current amortization method and the fair value measurement method. At initial adoption, SFAS No. 156 permits a one time reclassification of available for sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available for sale securities under Statement 115, provided the securities are identified in some manner as offsetting the exposure to changes in fair value of servicing assets or servicing liabilities that are subsequently measured at fair value. Finally, SFAS No. 156 requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. The Company did not elect to subsequently measure any of our servicing rights at fair value or reclassify any AFS securities to trading. The prospective aspects of SFAS 156 did not and are not expected to have a material impact on our consolidated financial statements.

We adopted the provisions of Financial Accounting Standards Board ( FASB ) Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 ( FIN 48 ), on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement 109, Accounting for Income Taxes, and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

Based on our evaluation, we have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements. Our evaluation was performed for the tax years ended December 31, 2003, 2004, 2005 and 2006, the tax years which remain subject

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to examination by major tax jurisdictions as of June 30, 2007.

We may from time to time be assessed interest and/or penalties by major taxing jurisdictions, although any such assessments historically have been minimal and immaterial to our financial results. In the event we have received an assessment for interest and/or penalties, it has been classified in the statement of operations as other general and administrative costs.

**Table of Contents****NOTE 3 DIVESTITURE:**

In October 2006, the Company decided to discontinue one of its businesses included in the All other segment. The results of the discontinued business have been included in discontinued operations in the consolidated statement of operations in accordance with SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets .

Summarized results of the Company's discontinued operations are as follows for the six months ended June 30:

(In thousands):	2007	2006
Total revenues	\$ 335	\$ 1,573
Total expenses	(1,100)	(932)
(Loss) income before provision for income taxes	(765)	641
Benefit (provision) for income taxes	274	(285)
(Loss) income from discontinued operations, net of taxes	\$ (491)	\$ 356

The properties were sold in February and March 2007. Gross proceeds from the sales and insurance recoveries were \$1,572,000 and the gain on the sale was \$198,000.

**NOTE 4 SBA LOANS:**

SBA Loans are primarily concentrated in the hotel and motel, and restaurant industries. Below is a summary of the activity in the SBA loan receivable balance, net of SBA loan loss reserves for the six months ended June 30, 2007 (In thousands):

Balance at December 31, 2006	\$ 27,746
Loans originated for investment	4,537
Payments received	(3,992)
Loans held for investment, reclassified as held for sale	(1,857)
Loans foreclosed into real estate owned	(36)
Provision for loan losses	(372)
Discount on loan originations, net	(28)
Balance at June 30, 2007	\$ 25,998

Below is a summary of the activity in the reserve for loan losses balance for the six months ended June 30, 2007 (In thousands):

Balance at December 31, 2006	\$ 2,332
Loan loss provision	371
Recoveries	22
Loan charge-offs	(127)
Balance at June 30, 2007	\$ 2,598

Below is a summary of the activity in the SBA loans held for sale for the six months ended June 30, 2007 (In thousands):



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Balance at December 31, 2006	\$ 1,786
Loan originations for sale	14,284
Loans held for investment, reclassified as held for sale	1,857
Loans sold	(15,564)
Balance at June 30, 2007	\$ 2,363

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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 June 30, 2007 and December 31, 2006, net SBA loans receivable held for investment with adjustable interest rates amounted to \$25,371,000 and \$26,815,000, respectively.

For the six months ended June 30, 2007 and 2006, the Company funded approximately \$18,821,000 and \$21,675,000 in loans and sold approximately \$13,707,000 and \$14,326,000 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 June 30, 2007 and December 31, 2006 amounted to \$49,000 and \$516,000, respectively.

As of June 30, 2007 and December 31, 2006, total impaired non-accrual loans amounted to \$5,661,000 and \$5,293,000, respectively. For the six months ended June 30, 2007 and for the year ended December 31, 2006, the average balance of impaired non-accrual loans was \$5,656,000 and \$4,507,000, respectively. Approximately \$1,508,000 and \$1,036,000, respectively, of the allowance for loan losses were allocated against such impaired nonaccrual loans 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:

<b>(In thousands):</b>	<b>June 30, 2007</b>	<b>December 31, 2006</b>
Due in one year or less	\$ 8	\$ 15
Due between one and five years	1,526	1,585
Due after five years	28,739	30,127
Total	30,273	31,727
Less : Allowance for loan losses	(2,598)	(2,332)
Less: Deferred origination fees, net	(1,677)	(1,649)
Balance (net)	\$ 25,998	\$ 27,746

**NOTE 5 INVESTMENTS IN QUALIFIED BUSINESSES:****HELD TO MATURITY DEBT INVESTMENTS Summary (In thousands)**

	<b>Total</b>
Principal outstanding at December 31, 2006	\$ 5,301
Return of principal	(1,332)
Consolidation of CDS pursuant to FIN 46R	(2,050)
Principal outstanding at June 30, 2007	\$ 1,919

**COST INVESTMENTS Summary (In thousands)**

Total cost investments at December 31, 2006	\$ 542
Return of investments	(38)
Total cost investments at June 30, 2007	\$ 504

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The Company has not guaranteed any obligation of these investees and the Company is not otherwise committed to provide further financial support for the investees. However, from time-to-time, the Company may decide to provide such additional financial support which, as of June 30, 2007 was zero. Should the Company determine that an impairment exists upon its periodic review, and it is deemed to be other than temporary, the Company will reduce the recorded value of the asset to its estimated fair value and record a corresponding charge in the condensed consolidated statements of operations.

**Table of Contents****NOTE 6 SERVICING ASSETS:**

Servicing rights are recognized as assets when SBA loans are sold and the rights to service those loans are retained. Through December 31, 2006, the Company recorded its servicing rights at their relative fair values on the date the loans were sold and were carried at the lower of the initial recorded value, adjusted for amortization, or fair value. As of January 1, 2007, the Company adopted the provisions of SFAS No. 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 six months ended June 30, 2007 were as follows:

<b>(In thousands):</b>	
Balance at December 31, 2006	\$ 3,252
Servicing assets capitalized	504
Servicing assets amortized	(479)
 Balance at June 30, 2007	 3,277
 Reserve for impairment of servicing assets:	
Balance at December 31, 2006	(261)
Additions	
 Balance at June 30, 2007	 (261)
 Balance at June 30, 2007 (net of reserve)	 \$ 3,016

The estimated fair value of capitalized servicing rights was \$3,016,000 and \$2,991,000 at June 30, 2007 and December 31, 2006, respectively. The estimated fair value of servicing assets at both balance sheet dates was determined using a discount rate of 13.3%, weighted average prepayment speeds ranging from 1% to 23%, depending upon certain characteristics of the loan portfolio, a weighted average life of 3.3 years, and an average default rate of 3%.

The unpaid principal balances of loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of loans serviced for others were \$156,414,000 and \$163,277,000 as of June 30, 2007 and December 31, 2006, respectively.

**NOTE 7 GOODWILL/CONSOLIDATION OF CDS BUSINESS SERVICES, INC:**

In January 2007, it was determined that the Company would consolidate one of its qualified investments, CDS Business Services, Inc. ( CDS ) under the provisions of FIN 46 (R). At the time of consolidation, the opening balance sheet of CDS was as follows (inclusive of intercompany accounts):

<b>(In thousands):</b>	
Cash	\$ 233
Restricted cash	2,050
Accounts receivable, net	3,579
Prepaid expenses and other assets	94
Intangible assets, net	800
 Total assets	 6,756

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Accounts payable and accrued expenses	3,127
Notes payable	6,109
<b>Total liabilities assumed</b>	<b>9,236</b>
Goodwill recognized	\$ 2,480

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The difference between the assets and liabilities has been recorded as goodwill. The Company's purchase price allocations are preliminary and have not been finalized.

**NOTE 8 BANK NOTES PAYABLE:**

In February 2007, CDS Business Services, Inc., one of the Company's FIN 46 subsidiaries, closed a two year \$10,000,000 line of credit with Wells Fargo. This new facility will be used to purchase receivables and for other working capital purposes. As of June 30, 2007, CDS had \$1,912,000 outstanding on the line of credit. The interest rate is prime plus 2% with interest on the line being paid monthly in arrears and on a minimum outstanding line balance of \$2,000,000. Total interest expense for the six months ended June 30, 2007 was approximately \$84,000. The line is collateralized by the receivables purchased, as well as all other assets of the company. Through June 30, 2007, CDS has capitalized \$148,000 of deferred financing costs attributable to the Wells Fargo line. Such costs are being amortized over two years and are included in prepaid expenses and other assets in the accompanying consolidated balance sheet. Amortization for the six months ended June 30, 2007 was \$25,000. The agreement includes such financial covenants as minimum tangible net worth, minimum quarterly net income and minimum quarterly net cash flow.

**NOTE 9 COMMON STOCK:**

On January 26, 2007, in connection with a legal settlement, the Company issued 171,795 shares valued at \$344,000 to a former employee. Of the 171,795 shares issued, 86,290 shares are registered under the Company's 2003 Stock Incentive Plan and 85,505 shares are unregistered. The fair market value was determined using the fair value of the underlying common stock at the date of the stipulation of settlement.

Additionally, in 2004 two officers of the Company elected to receive their bonus, aggregating \$325,000, as deferred compensation. In connection with such agreement, the compensation was to be delivered in the form of Company stock in March 2007. On March 30, 2007, the Company issued a total of 72,394 shares of common stock with a fair market value of \$177,000 to such officers. The shares were issued in reliance on Section 4(2) of the Securities Act of 1933, as amended.

Pursuant to the terms of the Company's directors' compensation program, during the six months ended June 30, 2007, Newtek issued an aggregate of 44,683 unregistered common shares to the board of directors, valued at \$92,000. The fair market values of these grants were determined using the average of the high and low price for the three days preceding the grant date.

**NOTE 10 TREASURY STOCK:**

Shares of common stock repurchased by us are recorded at cost as treasury stock and result in a reduction of shareholders' equity in our Consolidated Balance Sheet. From time to time, treasury shares may be reissued as part of our stock based compensation programs. When shares are reissued, we use the weighted average cost method for determining cost. The difference between the cost of the shares and the issuance price is charged to compensation expense and added or deducted from additional contributed capital.

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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. During the three months ended June 30, 2007, the Company purchased an additional 12,265 treasury shares under that authorization.

**NOTE 11 EARNINGS (LOSS) PER SHARE:**

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

The calculations of earnings (loss) per share were:

<b>(In thousands except per share data):</b>	<b>Three Months Ended June 30, 2007</b>	<b>Three Months Ended June 30, 2006</b>	<b>Six Months Ended June 30, 2007</b>	<b>Six Months Ended June 30, 2006</b>
<b>Numerator:</b>				
Numerator for basic and diluted EPS loss from continuing operations	\$ (2,101)	\$ (2,346)	\$ (4,795)	\$ (5,371)
Numerator for basic and diluted EPS (loss) income from discontinued operations	(286)	59	(491)	356
Numerator for basic and diluted EPS loss available to common shareholders	\$ (2,387)	\$ (2,287)	\$ (5,286)	\$ (5,015)
<b>Denominator:</b>				
Denominator for basic and diluted EPS weighted average shares	35,868	34,696	35,720	34,765
Net loss per share from continuing operations: Basic and diluted	\$ (0.06)	\$ (0.07)	\$ (0.13)	\$ (0.15)
Net (loss) income per share from discontinued operations: Basic and diluted	(0.01)	0.00	(0.02)	0.01
Loss per share: Basic and diluted	\$ (0.07)	\$ (0.07)	\$ (0.15)	\$ (0.14)

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

Stock options and restricted stock	873	1,748	823	1,748
Warrants	216	216	216	216
Contingently issuable shares	583	861	583	861

**NOTE 12 SUBSEQUENT EVENT:**

On July 1, 2007, Business Connect, LLC, a Texas limited liability company which is an investment of Wilshire Texas Partners, LLC, a Texas Capco, purchased a merchant processing credit card portfolio with approximately 1,050 customers from Axeus Services, Inc. for a purchase price of \$2,150,000. This portfolio has annual processing volume of approximately \$47 million.

In July 2007, the Company relocated its web hosting business. In accordance with FAS 146, the Company is evaluating whether or not a liability is required in connection with its lease on its former location. Management believes that the cost of this relocation, including the abandonment of its existing facility, will not have a material impact on the Company's consolidated financial position and results of operations.

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**NOTE 13 SEGMENT REPORTING:**

Operating segments are organized internally primarily by the type of services provided, and in accordance with SFAS 131, Disclosures About Segments of an Enterprise and Related Information, the Company has aggregated similar operating segments into six reportable segments: SBA lending, electronic payment processing, web hosting, Capcos, corporate activities and all other.

Effective in the fourth quarter of 2005, the Company increased the number of operating segments from four to six. 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 SBA lending segment is NSBF, a 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.

As an SBA lender, 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 also generates expenses such as interest, professional fees, payroll and consulting, depreciation and amortization, and provision for loan losses, all of which are included in the respective caption on the condensed consolidated statement 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 electronic payment processing segment is a marketer of credit card and check approval services to the small business market. Revenue generated from electronic payment processing is included on the condensed consolidated statements of income as a separate line item. Expenses include direct costs (included in a separate line captioned electronic payment processing direct costs), professional fees, payroll and consulting, and other general and administrative costs, 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 set up fees. CrystalTech generates expenses such as professional fees, payroll and consulting, 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 general and administrative costs caption in the respective caption on the condensed consolidated statements of operations.

The Capco segment, which consists of the fifteen 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, professional fees consisting of management fees paid to Newtek, legal and auditing fees and losses from investments in qualified businesses.

The all other segment includes revenue and expenses from businesses formed from qualified investments made through the Capco programs which cannot be aggregated with other operating segments.

Corporate activities represent revenue and expenses not allocated to our segments. Revenue includes interest income and management fees earned from Capcos. 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.

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

the nature of the product and services,

the type or class of customer for their products and services,



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the methods used to distribute their products or provide their services, and

the nature of the regulatory environment, for example, banking, insurance, or public utilities.

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

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(In thousands)

	For the three months ended June 30, 2007	For the three months ended June 30, 2006	For the six months ended June 30, 2007	For the six months ended June 30, 2006
<b>Third Party Revenue</b>				
Electronic payment processing	\$ 13,070	\$ 10,561	\$ 25,627	\$ 20,037
Web hosting	3,950	3,317	7,838	6,520
SBA lending	2,609	2,361	4,924	4,483
Capcos	1,720	2,376	3,356	3,944
All other	2,188	781	3,707	1,656
Corporate activities	1,106	1,244	2,232	2,507
<b>Total reportable segments</b>	24,643	20,640	47,684	39,147
Eliminations	(1,232)	(1,214)	(2,464)	(2,575)
<b>Consolidated Total</b>	\$ 23,411	\$ 19,426	\$ 45,220	\$ 36,572
<b>Inter-Segment Revenue</b>				
Electronic payment processing	\$ 117	\$ 100	\$ 229	\$ 184
Web hosting	49	17	95	32
SBA lending				
Capcos	651	317	1,152	637
All other	236	459	440	648
Corporate activities	679	538	1,258	1,069
<b>Total reportable segments</b>	1,732	1,431	3,174	2,570
Eliminations	(1,732)	(1,431)	(3,174)	(2,570)
<b>Consolidated Total</b>	\$	\$	\$	\$

**Table of Contents****Income (loss) before benefit for income taxes and discontinued operations**

Electronic payment processing	\$ 865	\$ 723	\$ 1,704	\$ 1,137
Web hosting	999	1,048	2,023	2,051
SBA lending	217	(102)	210	(158)
Capcos	(3,333)	(3,185)	(6,872)	(7,327)
All other	199	(707)	(173)	(1,543)
Corporate activities	(1,765)	(1,237)	(3,776)	(2,252)
<b>Totals</b>	<b>\$ (2,818)</b>	<b>\$ (3,460)</b>	<b>\$ (6,884)</b>	<b>\$ (8,092)</b>

**Depreciation and Amortization**

Electronic payment processing	\$ 442	\$ 355	\$ 890	\$ 639
Web hosting	801	614	1,555	1,172
SBA lending	399	414	779	810
Capcos	13	47	28	52
All other	88	58	159	131
Corporate activities	60	39	120	78
<b>Totals</b>	<b>\$ 1,803</b>	<b>\$ 1,527</b>	<b>\$ 3,531</b>	<b>\$ 2,882</b>

	<b>As of June 30, 2007</b>	<b>As of December 31, 2006</b>
<b>Identifiable assets</b>		
Electronic payment processing	\$ 13,066	\$ 12,302
Web hosting	14,485	14,687
SBA Lending	38,595	39,028
Capcos	133,654	146,992
All other	23,070	21,220
Corporate activities	4,466	6,508
<b>Consolidated total</b>	<b>\$ 227,336</b>	<b>\$ 240,737</b>

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### **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 through our wholly and majority owned subsidiaries. Our target market represents a very significant marketplace in the United States gross domestic product or GDP. According to statistics published by the U.S. Small Business Administration, approximately 51% of the GDP in the United States comes from small-to medium-size businesses and 99% of businesses in the United States which have one or more employees fit into this market segment. As of June 30, 2007, we had over 79,000 business accounts. 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- size business clients. We partner with AIG, Merrill Lynch, Morgan Stanley, UBS, IntegraSys - a Fiserv Company, the Credit Union National Association with its 8,700 credit unions and 80 million members, the Navy Federal Credit Union with 2.7 million members, PSCU Financial Services, Inc., the nation's largest credit union service organization, 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.

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The Company's reportable business segments are:

**Electronic Payment Processing:** Marketing, credit card processing and check approval services.

**Web Hosting:** CrystalTech Web Hosting, Inc., which offers shared and dedicated web hosting and related services.

**SBA Lending:** 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.

**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:** 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.

**Comparison of the three months ended June 30, 2007 and June 30, 2006**

Revenue and expenses which are specific to a segment are discussed in Segment Results, which follows. Electronic payment processing revenue and electronic payment processing costs are included in the Electronic payment processing segment. Web hosting revenue is included in the Web hosting segment. Premium income revenue, servicing fee revenue and provision for loan losses expense are included in the SBA lending segment. Income from tax credits revenue is included in the Capco segment.

Revenues increased by \$3,985,000, or 21%, to \$23,411,000 for the three months ended June 30, 2007, from \$19,426,000 for the three months ended June 30, 2006 primarily due to the increase in revenues in the Electronic payment processing, Web hosting, and All other segments of \$2,509,000, \$633,000 and \$1,506,000 respectively.

Interest income is generated from SBA lending activities, excess cash balances that are invested in money market accounts, U.S. Treasury notes, non-cash accretions of structured insurance product and on held to maturity investments. The following table details the changes in these different forms of interest income:

(In thousands)	2007	2006	Change
SBA lending	\$ 1,023	\$ 992	\$ 31
Other interest income	523	931	(408)
	\$ 1,546	\$ 1,923	\$ (377)

Other income increased by \$1,866,000, or 837%, to \$2,089,000 for the three months ended June 30, 2007 from \$223,000 for the three months ended June 30, 2006 primarily due to the gain on the sale and recoveries of investments in qualified businesses of \$1,032,000 and the consolidation of CDS Business Services, Inc. which produced revenues of \$476,000 for the first time this period. Other income generally represents revenues from entities that cannot be aggregated into any of our other major operating segments.

Consulting, payroll and benefits increased by \$1,149,000, or 28%, to \$5,224,000 for the three months ended June 30, 2007 from \$4,075,000 for the three months ended June 30, 2006 primarily due to the increasing employee headcount.

Changes in interest expense are summarized as follows:

(In thousands)	2007	2006	Change
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Capco interest expense	\$ 3,016	\$ 3,320	\$ (304)
SBA lending	472	612	(140)
Other interest expense	126	645	(519)
	\$ 3,614	\$ 4,577	\$ (963)

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The decrease in Capco interest expense relates to the decrease in the principal outstanding on the notes payable to AI Credit from \$7,312,000 as of June 30, 2006, to \$1,019,000 as of June 30, 2007. The decrease in SBA interest expense is attributable to the decrease in bank notes payable from \$22,009,000 at June 30, 2006 to \$16,696,000 at June 30, 2007. The decrease in other interest expense is primarily attributable the decrease in principal outstanding on the note payable to TICC.

Professional fees increased by \$309,000, or 16%, to \$2,183,000 for the three months ended June 30, 2007 from \$1,874,000 for the three months ended June 30, 2006 primarily due to increased residual payments to independent sales agents and offices offset by a decrease in audit fees.

Depreciation and amortization expense increased by \$276,000, or 18%, to \$1,803,000 for the three months ended June 30, 2007 from \$1,527,000 for the three months ended June 30, 2006. This is due to the purchase of \$2,958,000 of fixed assets during the twelve months ended March 31, 2007.

Insurance expense increased by \$33,000, or 4%, to \$873,000 for the three months ended June 30, 2007 from \$840,000 for the three months ended June 30, 2006.

Other general and administrative costs (consisting of occupancy, selling, general and administrative) increased by \$429,000, or 19%, to \$2,729,000 for the three months ended June 30, 2007 from \$2,300,000 for the three months ended June 30, 2006. The increase in overall other general and administrative costs relates to additional expenses incurred in connection with the growth of our business and head count.

Income (loss) from discontinued operations, net of taxes, decreased by \$345,000, to a loss of \$286,000 for the three months ended June 30, 2007 from income of \$59,000 for the three months ended June 30, 2006. Discontinued operations are related to Phoenix Development Group, LLC, a Capco investment made during the fourth quarter of 2005 which provided services in connection with the reconstruction of New Orleans, primarily in the form of temporary housing and related services. Total revenues from discontinued operations decreased by \$540,000, to \$17,000 for the three months ended June 30, 2007 from \$557,000 for the three months ended June 30, 2006. This was offset by an increase in minority interest of \$21,000, to \$33,000 in 2007 from \$12,000 in 2006, and an increase in the (provision) benefit for income taxes of \$216,000, to \$169,000 in 2007 from \$(47,000) in 2006.

The effective tax benefit for the three months ended June 30, 2007 and 2006 was 25% and 32%, respectively. No tax benefit was recorded for the losses of NSBF (in both 2007 and 2006) and CDS Business Services, Inc. (2007 only), as those subsidiaries are not included in the consolidated tax group. There were no material permanent differences in either year.

Net loss increased by \$100,000, or 4%, to \$2,387,000 for the three months ended June 30, 2007 from \$2,287,000 for the three months ended June 30, 2006, due to the increase in revenue of \$3,985,000, offset by an increase in total expenses of \$3,302,000, and a decrease in minority interest of \$41,000, offset by a decrease in the tax benefit of \$397,000 and an decrease in discontinued operations of \$345,000.

**Comparison of the six months ended June 30, 2007 and June 30, 2006**

*Revenue and expenses which are specific to a segment are discussed in Segment Results, which follows. Electronic payment processing revenue and electronic payment processing costs are included in the Electronic payment processing segment. Web hosting revenue is included in the Web hosting segment. Premium income revenue, servicing fee revenue and provision for loan losses expense are included in the SBA lending segment. Income from tax credits revenue is included in the Capco segment.*

Revenues increased by \$8,648,000, or 24%, to \$45,220,000 for the six months ended June 30, 2007, from \$36,572,000 for the six months ended June 30, 2006 primarily due to the increase in revenues in the Electronic payment processing, Web hosting and All other segments of \$5,590,000, \$1,318,000 and \$2,051,000, respectively.

Interest is generated from SBA lending activities, excess cash balances that are invested in money market accounts, U.S. Treasury notes, federal government backed securities mutual funds, etc., non-cash accretions of structured insurance product and on held to maturity investments. The following table details the changes in these different forms of interest:

(In thousands)	2007	2006	Change
SBA lending	\$ 1,955	\$ 1,835	\$ 120
Other interest income	1,083	1,501	(418)

\$ 3,038    \$ 3,336    \$ (298)



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Other income increased by \$2,568,000, or 345%, to \$3,313,000 for the six months ended June 30, 2007 from \$745,000 for the six months ended June 30, 2006 primarily due to the gain on the sale of an investment in a qualified business and the consolidation of CDS Business Services, Inc for the first time this period. Other income generally represents revenues from entities that cannot be aggregated into any of our other major operating segments.

Consulting, payroll and benefits increased by \$2,616,000, or 32%, to \$10,737,000 for the six months ended June 30, 2007 from \$8,121,000 for the six months ended June 30, 2006 primarily due to the increasing employee headcount.

Changes in interest expense by segment are summarized as follows for the six months ended June 30:

(In thousands)	2007	2006	Change
Capco interest expense	\$ 6,146	\$ 6,663	\$ (517)
SBA lending	929	1,124	(195)
Other interest expense	261	1,098	(837)
	\$ 7,336	\$ 8,885	\$ (1,549)

The decrease in Capco interest expense relates to the decrease in the principal outstanding on the notes payable to AI Credit from \$7,312,000 as of June 30, 2006, to \$1,019,000 as of June 30, 2007. The decrease in SBA interest expense is attributable to the decrease in bank notes payable from \$22,009,000 at June 30, 2006 to \$16,696,000 at June 30, 2007. The decrease in other interest expense is primarily attributable the decrease in principal outstanding on the note payable to TICC

Professional fees increased by \$74,000, or 4%, to \$4,002,000 for the six months ended June 30, 2007 from \$3,928,000 for the six months ended June 30, 2006 primarily due to increased residual payments to independent sales agents and offices offset by a decrease in audit fees.

Depreciation and amortization expense increased by \$649,000, or 23%, to \$3,531,000 for the six months ended June 30, 2007 from \$2,882,000 for the six months ended June 30, 2006. This is due to the purchase of \$2,958,000 of fixed assets during the twelve months ended March 31, 2007.

Insurance expense decreased by \$17,000, or 0.36%, to \$1,686,000 for the six months ended June 30, 2007 from \$1,703,000 for the six months ended June 30, 2006.

Other general and administrative costs (consisting of occupancy, selling, general and administrative) increased by \$1,337,000, or 29%, to \$5,996,000 for the six months ended June 30, 2007 from \$4,659,000 for the six months ended June 30, 2006. The increase in overall other general and administrative costs relates to additional expenses incurred in connection with the growth of our business and head count.

Income (loss) from discontinued operations, net of taxes, decreased by \$847,000, to a loss of \$491,000 for the six months ended June 30, 2007 from income of \$356,000 for the six months ended June 30, 2006. Discontinued operations are related to Phoenix Development Group, LLC, a Capco investment made during the fourth quarter of 2005 which provided services to and reconstruction of New Orleans, primarily in the form of temporary housing and related services. Total revenues from discontinued operations decreased by \$1,238,000, to \$335,000 for the six months ended June 30, 2007 from \$1,573,000 for the six months ended June 30, 2006. This was offset by an increase in total expenses of \$156,000 to \$1,015,000 for the six months ended June 30, 2007 from \$860,000 for the six months ended June 30, 2006, an increase in minority interest by \$13,000, to \$84,000 in 2007 from \$71,000 in 2006, and an increase in the (provision) benefit for income taxes of \$559,000, to \$274,000 in 2007 from \$(285,000) in 2006.

The effective tax benefit for the six months ended June 30, 2007 and 2006 was 30% and 34%, respectively. No tax benefit was recorded for the losses of NSBF (in both 2007 and 2006) and CDS Business Services, Inc. (2007 only), as those subsidiaries are not included in the consolidated tax group. There were no material permanent differences in either year.

Net loss increased by \$270,000, or 5%, to \$5,286,000 for the six months ended June 30, 2007 from \$5,015,000 for the six months ended June 30, 2006, due to the increase in revenue of \$8,648,000, offset by an increase in total expenses of \$7,289,000, and a decrease in minority interest of \$150,000, offset by a decrease in the tax benefit of \$631,000 and an decrease in discontinued operations of \$848,000.



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The results of the Company's reportable segments for the three and six months ended June 30, 2007 as compared to the three and six months ended June 30, 2006 are discussed below.

**Electronic Payment Processing****For the three months ended June 30, 2007 and 2006:**

<b>(In thousands):</b>	<b>2007</b>	<b>2006</b>	<b>\$ Change</b>	<b>% Change</b>
Revenue	\$ 13,070	\$ 10,561	\$ 2,509	24 %
Expenses	(12,205)	(9,838)	(2,367)	(24)%
Income from continuing operations before benefit for income taxes and discontinued operations	\$ 865	\$ 723	\$ 142	20 %

Revenues increased by \$2,509,000 to \$13,070,000 due to a \$2,503,000 increase in electronic payment processing revenue and a \$6,000 increase in interest and other income. All of the increase in electronic payment processing revenue was due to organic sales growth. Gross total processing volume increased 38% to \$582,871,000 for the three months ended June 30, 2007, from \$423,455,000 for the three months ended June 30, 2006.

Expenses increased by \$2,367,000 to \$12,205,000 due primarily to a \$2,099,000 increase in electronic payment processing costs, a \$221,000 increase in professional fees, which consist principally of residual payments to independent sales agents and offices, and an \$88,000 increase in depreciation and amortization. The increase in electronic payment processing costs correlates to the significant increase in revenue coupled with an increase in higher volume customers which generate higher costs as a percentage of revenue.

**For the six months ended June 30, 2007 and 2006:**

<b>(In thousands):</b>	<b>2007</b>	<b>2006</b>	<b>\$ Change</b>	<b>% Change</b>
Revenue	\$ 25,627	\$ 20,037	\$ 5,590	28 %
Expenses	(23,923)	(18,900)	(5,023)	(27)%
Income from continuing operations before benefit for income taxes and discontinued operations	\$ 1,704	\$ 1,137	\$ 567	50 %

Revenues increased by \$5,590,000 to \$25,627,000 due to a \$5,588,000 increase in electronic payment processing revenue and a \$2,000 increase in interest and other income. The \$5,588,000 increase in electronic payment processing revenue was almost entirely due to an increase in organic sales growth. Gross total processing volume increased by 29% to \$1,214,907,000 for the six months ended June 30, 2007, from \$945,087,000 for the six months ended June 30, 2006.

Expenses increased by \$5,023,000 to \$23,923,000 due primarily to a \$4,162,000 increase in electronic payment processing costs, a \$542,000 increase in professional fees, which consist principally of residual payments to independent sales agents and offices, a \$251,000 increase in depreciation and amortization, and a \$129,000 increase in consulting, payroll and benefits. The increase in electronic payment processing costs correlates to the significant increase in revenues coupled with an increase in higher volume customers which generate higher costs as a percentage of revenue.

**Table of Contents****Web Hosting****For the three months ended June 30, 2007 and 2006:**

<b>(In thousands):</b>	<b>2007</b>	<b>2006</b>	<b>\$ Change</b>	<b>% Change</b>
Revenue	\$ 3,950	\$ 3,317	\$ 633	19 %
Expenses	(2,951)	(2,269)	(682)	(30)%
Income from continuing operations before benefit for income taxes and discontinued operations	\$ 999	\$ 1,048	\$ (49)	(5)%

Revenue is derived primarily from monthly recurring fees from hosting dedicated and shared websites.

Web hosting revenues increased by \$633,000, or 19%, to \$3,950,000 for the three months ended June 30, 2007 from \$3,317,000 for the three months ended June 30, 2006. The increase in revenue is due to the overall increase in the number of customers the Company provided services to and an increase in dedicated hosting customers which generate higher revenue per customer.

The average number of total websites for the three months ended June 30, 2007 increased 20% to 62,000 from 52,000 for the three months ended June 30, 2006. The average number of dedicated websites, which generate a higher monthly fee, increased 42% to 2,000 in 2007, from 1,400 in 2006. The average number of shared websites increased 19% to 60,000, per month in 2007, from 50,000, in 2006.

The \$682,000 increase in expenses in 2007 compared with 2006 was primarily due to a \$234,000 increase in consulting, payroll and benefits, a \$187,000 increase in depreciation and amortization, and a \$402,000 increase in other expenses, offset, in part, by a \$90,000 decrease in interest expense due to lower borrowings from TICC during 2007. Consulting, payroll and benefits increased due to additional personnel added to service the increased customer base and to extend the hours of operation in customer service. Depreciation and amortization increased due to additional capital expenditures of \$2,174,000 over the past twelve months primarily for additional servers. Other expenses increased primarily due to \$234,000 in additional software licenses required for additional servers, a \$76,000 increase in rent and utilities related to a new space, and a \$51,000 increase in marketing costs.

**For the six months ended June 30, 2007 and 2006:**

<b>(In thousands):</b>	<b>2007</b>	<b>2006</b>	<b>\$ Change</b>	<b>% Change</b>
Revenue	\$ 7,838	\$ 6,520	\$ 1,318	20 %
Expenses	(5,815)	(4,469)	(1,346)	(30)%
Income from continuing operations before benefit for income taxes and discontinued operations	\$ 2,023	\$ 2,051	\$ (28)	(1)%

Revenue is derived primarily from monthly recurring fees from hosting dedicated and shared websites.

Web hosting revenue increased by \$1,318,000, or 20%, to \$7,838,000 for the six months ended June 30, 2007 from \$6,520,000 for the six months ended June 30, 2006. The increase in revenue is due to the overall increase in the number of customers the Company provided services to and an increase in dedicated hosting customers which generate higher revenue per customer.

The average number of total websites increased 24% to 61,000 in 2007, from 50,000 in 2006. The average number of dedicated websites, which generate a higher monthly fee, increased 47%, to 1,900 per month in 2007, from 1,300 in 2006. The average number of shared websites increased 21% to 59,000, per month in 2007, from 49,000, in 2006.

The \$1,346,000 increase in expenses for the six months ended June 30, 2007 compared to the six months ended June 30, 2006 was primarily due to a \$512,000 increase in consulting, payroll and benefits, a \$383,000 increase in depreciation and amortization, and a \$857,000 increase in other expenses, offset, in part, by a \$324,000 decrease in interest expense due to lower principal outstanding on the TICC debt during 2007.

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Consulting, payroll and benefits increased due to additional personnel added to service the increased customer base and to extend the hours of operation in customer service. Depreciation and amortization increased due to additional capital expenditures of \$2,174,000 over the past twelve months primarily for additional servers. Other expenses increased primarily due to \$443,000 in additional software licenses required for additional servers, a \$164,000 increase in rent and utilities and a \$60,000 increase in marketing costs.

**Table of Contents****SBA Lending****For the three months ended June 30, 2007 and 2006:**

(In thousands):	2007	2006	\$ Change	% Change
Revenue	\$ 2,609	\$ 2,361	\$ 248	11%
Expenses	(2,392)	(2,463)	71	3%
Income (loss) from continuing operations before benefit for income taxes and discontinued operations	\$ 217	\$ (102)	\$ 319	313%

Revenue is derived primarily from premium income generated by the sale of the guaranteed and unguaranteed portions of SBA loans, interest income on SBA loans and servicing fee income on SBA loans previously sold.

Premium income related to SBA loans increased by \$34,000 to \$797,000 for the three months ended June 30, 2007 from \$763,000 for the three month period ended June 30, 2006. The increase in premium income was primarily attributable to the sale of loans previously classified as held for investment and the discount recognized thereon. In the three months ended June 30, 2007, NSBF sold \$1,911,000 of loans previously classified as held for investment, for aggregate proceeds of \$2,007,000. The carrying value above the amounts sold of \$93,000 was recorded as premium income. Also, in connection with this sale, included in premium income for the three months ended June 30, 2007 is \$133,000, representing the allocated portion of the remaining discount recorded at the time of loan origination, for total premium recognized of \$226,000. In the three months ended June 30, 2006, NSBF sold \$2,814,000 of loans previously classified as held for investment, for aggregate proceeds of \$2,959,000. The carrying value above the amounts sold of \$145,000 was recorded as premium income. Also, in connection with this sale, included in premium income for the three months ended June 30, 2007 is \$21,000, representing the allocated portion of the remaining discount recorded at the time of loan origination, for total premium recognized of \$166,000.

The increase in premium income discussed above was partially offset by NSBF selling \$7,112,000 guaranteed loans in the three months ended June 30, 2007 as compared to \$8,057,000 guaranteed loans sold in the same period for the prior year, a reduction of \$945,000. As a result of the Company implementing the accounting principals under FAS156 which resulted in an increase in the premium recognized on a loan by loan basis, as compared with FAS140, this resulted in NSBF recognizing just \$25,000 less in premium income for the three month period ended June 30, 2007 compared to the same period in 2006.

Servicing fee income related to SBA loans increased by \$9,000 to \$496,000 for the three months ended June 30, 2007 from \$487,000 for the three month period ended June 30, 2006. The increase in servicing fee income was attributable to NSBF recognizing \$92,000 in servicing income associated with the servicing of an SBA portfolio for a savings bank in New York. This increase was partially offset as a result of a decrease in the NSBF servicing portfolio year over year. The average portfolio in which we earned servicing fee income for the quarter ended June 30, 2007 was \$133,341,000 compared with \$148,831,000 at June 30, 2006.

Interest income increased by \$31,000 due to an increase in the prime rate from 7.75% in the three months ending June 30, 2006 to 8.25% in the three months ending June 30, 2007, offset by the decrease in the average outstanding portfolio balance from \$40,321,000 to \$36,632,000 for the same period. Additionally, the company recognized an additional \$33,000 in deferred loan origination costs as a result of an increase in prepaids for the three month period ending June 30, 2007 as compared to the three month period ended June 30, 2006.

Other income increased by \$174,000 to \$293,000 for the three months ended June 30, 2007 from \$119,000 for the same period in 2006. A majority of this increase was attributable to a recovery on a loan that was charged off several years ago under the old ownership of Commercial Capital Corp.

Expenses decreased by \$71,000 in 2007 compared to 2006, primarily due to a decrease in interest expense, provision for loan loss and professional fees, offset by the write-down of the fair value of Other Real Estate Owned (OREO). Interest expense decreased by \$140,000 as a result of a decrease in the average outstanding balance under the Company's credit facility. The average outstanding balance in the three month period ended June 30, 2007 was \$20,746,000 as compared with \$25,305,000 in the same period in the prior year. Additionally, the fees being charged to the unused portion of the line decreased as a result of the 2<sup>nd</sup> amendment entered into in December 2006, reducing the overall line from \$75,000,000 to \$50,000,000. The provision for loan loss decreased by \$30,000 as a result of the decrease in the NSBF retained loan receivable balance year over year. Professional fees decreased by \$73,000 due to a reduction in audit and tax expense. As a result of incurring significant costs associated with maintaining its interests in OREO property the Company incurred total write downs of OREO property in the

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three month period ended June 30, 2007 of \$183,000.

Management's ongoing estimates of the allowance for loan losses are particularly affected by the changing composition of the loan portfolio over the last few years. The loans acquired from CCC in December 2002, which are more seasoned than those originated by NSBF, comprise 19% of total loans held for investment as of June 30, 2007. Other portfolio characteristics, such as industry concentrations and loan collateral, which also impacts management's estimates of the allowance for loan losses, have also

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changed since the acquisition. The changing nature of the portfolio and the limited past loss experience on the newly originated portfolio has resulted in management's estimates of the allowance for loan losses being based more on subjective factors and less on empirically derived loss rates. Such estimates could differ from actual results, which may have a material effect on the Company's results of operations or financial condition.

**For the six months ended June 30, 2007 and 2006:**

(In thousands):	2007	2006	\$ Change	% Change
Revenue	\$ 4,924	\$ 4,483	\$ 441	10 %
Expenses	(4,714)	(4,641)	(73)	(2)%
Income (loss) from continuing operations before benefit for income taxes and discontinued operations	\$ 210	\$ (158)	\$ 368	233 %

Revenue is derived primarily from premium income generated by the sale of the guaranteed and unguaranteed portions of SBA loans, interest income on SBA loans and servicing fee income on SBA loans previously sold.

Premium income related to SBA loans increased by \$136,000 to \$1,513,000 for the six months ended June 30, 2007 from \$1,377,000 for the six month period ended June 30, 2006. The increase in premium income was attributable to the Company implementing the accounting principals under FAS156 which resulted in an increase in the premium recognized, as compared with FAS140, on each loan sale. NSBF sold 64 guaranteed loans in the six months ended June 30, 2007, aggregating \$13,707,000, with premium income recognized of \$1,287,000, compared with 60 loans sold aggregating \$14,326,000 in the same period for the prior year with premium income recognized of \$1,211,000.

Additionally, in the six months ended June 30, 2007, NSBF sold \$1,911,000 of loans previously classified as held for investment, for aggregate proceeds of \$2,007,000. The carrying value above the amounts sold of \$93,000 was recorded as premium income. Also, in connection with this sale, included in premium income for the six months ended June 30, 2007 is \$133,000, representing the allocated portion of the remaining discount recorded at the time of loan origination, for total premium recognized of \$226,000. In the six months ended June 30, 2006, NSBF sold \$2,814,000 of loans previously classified as held for investment, for aggregate proceeds of \$2,959,000. The carrying value above the amounts sold of \$145,000 was recorded as premium income. Also, in connection with this sale, included in premium income for the six months ended June 30, 2007 is \$21,000, representing the allocated portion of the remaining discount recorded at the time of loan origination, for total premium recognized of \$166,000.

Servicing fee income related to SBA loans decreased by \$46,000 from \$986,000 for the six months ended June 30, 2006 to \$940,000 for the six month period ended June 30, 2007. This decrease was attributable to a decrease in the NSBF servicing portfolio year over year. The average portfolio in which we earned servicing fee income for the six months ended June 30, 2007 was \$136,095,000 compared with \$149,533,000 for the six months ended June 30, 2006. This decrease was partially offset by NSBF recognizing \$92,000 in servicing income associated with the servicing of an SBA portfolio for a savings bank in New York.

Interest income increased by \$120,000 due to an increase in the weighted average prime rate from 7.50% in the six months ending June 30, 2006 to 8.25% in the six months ending June 30, 2007, offset by the decrease in the average outstanding portfolio balance from \$39,524,000 to \$37,492,000 for the same period. Additionally, the company recognized an additional \$83,000 in deferred loan origination costs as a result of an increase in prepaids for the six month period ending June 30, 2007 as compared to the six month period ended June 30, 2006.

Other income increased by \$231,000 to \$516,000 for the three months ended June 30, 2007 from \$285,000 for the same period in 2006. A majority of this increase was attributable to a recovery on a loan that was charged off several years ago under the old ownership of Commercial Capital Corp. as well as an additional \$59,000 of income being recognized in connection with the recovery of expenses associated with the sale of OREO properties.



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Expenses increased by \$73,000 in 2007 compared to 2006, primarily due to an increase in other general and administrative costs, specifically the write-down of the fair value of Other Real Estate Owned (OREO) as well as an increase in salary and benefits. As a result of incurring significant costs associated with maintaining its interests in OREO property the Company incurred total write downs of OREO property in the six month period ended June 30, 2007 of \$246,000. Salary and benefits increased by \$110,000 as a result of employees being hired at a more experienced level, thus requiring a higher salary. These additional costs were offset by the reduction in interest expense and professional fees. Interest expense decreased by \$194,000 as a result of a decrease in the average outstanding balance under the Company's credit facility. The average outstanding balance in the six month period ended June 30, 2007 was \$20,246,000 as compared with \$24,389,000 in the same period in the prior year. Additionally, the fees being charged to the unused portion of the line decreased as a result of the 2<sup>nd</sup> amendment entered into in December 2006, reducing the overall line from \$75,000,000 to \$50,000,000. Professional fees decreased by \$156,000 due to a reduction in audit and tax accruals.

**Capco**

For the three months ended June 30, 2007 and 2006:

(In thousands):	2007	2006	\$ Change	% Change
Revenue	\$ 1,720	\$ 2,376	\$ (656)	(28)%
Expenses	(5,109)	(5,658)	549	10 %
Loss from continuing operations before minority interest, benefit for income taxes and discontinued operations	(3,389)	(3,282)	(107)	(3)%
Minority interest	56	97	(41)	(42)%
Loss from continuing operations before benefit for income taxes and discontinued operations	\$ (3,333)	\$ (3,185)	\$ (148)	(5)%

Revenue is derived primarily from non-cash income from tax credits recorded when a Capco achieves defined investment percentage thresholds and from non-cash accretion of income from tax credits between the time the thresholds are achieved and the tax credits are utilized by the certified investor. Income from tax credits decreased by \$702,000 to \$1,320,000 for the three months ended June 30, 2007 from \$2,022,000 for the three months ended June 30, 2006. Income from tax credits for the three months ended June 30 are as follows:

(In thousands):	2007	2006
From investment percentage thresholds	\$ 1,320	\$ 746
From accretion of income from thresholds	1,320	1,276
Total	\$ 1,320	\$ 2,022

Expenses consist primarily of non-cash accretion of interest expense and the amortization of the prepaid insurance purchased at the funding date. Expenses for the three months ended June 30 are as follows:

(In thousands):	2007	2006
Accretion of interest expense	\$ 3,019	\$ 3,320
Amortization of prepaid insurance	740	740
Total	\$ 3,759	\$ 4,060

In summary, the non-cash loss which is represented by the income from tax credits, less interest expense and amortization of prepaid insurance, for the three months ended June 30 is as follows:

<b>(In thousands):</b>	<b>2007</b>	<b>2006</b>
Non-cash loss	\$ (2,439)	\$ (2,038)

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In addition, other interest relating to notes payable – AI Credit, totaling \$0 and \$194,000, was incurred in the three month periods ended June 30, 2007 and 2006, respectively, and management fees, which were payable to Newtek and included as revenue in the corporate activities segment, totaled \$1,117,000 and \$1,361,000, for the three month periods ended June 30, 2007 and 2006, respectively.

Since the Company does not anticipate creating any new Capcos in the foreseeable future, we anticipate incurring losses going forward. Income from tax credits will consist solely of accretion of income from thresholds previously achieved since we have achieved all investment percentage thresholds as of December 31, 2006. We will continue to incur non-cash expenses consisting of accretion of interest expense and amortization of prepaid insurance on our existing Capcos.

**For the six months ended June 30, 2007 and 2006:**

<b>(In thousands):</b>	<b>2007</b>	<b>2006</b>	<b>\$ Change</b>	<b>% Change</b>
Revenue	\$ 3,356	\$ 3,944	(588)	(15)%
Expenses	(10,407)	(11,601)	1,194	10 %
Loss from continuing operations before minority interest, benefit for income taxes and discontinued operations	(7,051)	(7,657)	606	8 %
Minority interest	179	330	(151)	(46)%
Loss from continuing operations before benefit for income taxes and discontinued operations	\$ (6,872)	\$ (7,327)	\$ 455	6 %

Revenue is derived primarily from non-cash income from tax credits recorded when a Capco achieves defined investment percentage thresholds and from non-cash accretion of income from tax credits between the time the thresholds are achieved and the tax credits are utilized by the certified investor. Income from tax credits decreased by \$659,000 to \$2,621,000 for the six months ended June 30, 2007 from \$3,280,000 for the six months ended June 30, 2006. Income from tax credits for the six months ended June 30 are as follows:

<b>(In thousands):</b>	<b>2007</b>	<b>2006</b>
From investment percentage thresholds	\$ 746	\$ 746
From accretion of income from thresholds	2,621	2,534
<b>Total</b>	<b>\$ 2,621</b>	<b>\$ 3,280</b>

Expenses consist primarily of non-cash accretion of interest expense and the amortization of the prepaid insurance purchased at the funding date. Expenses for the six months ended June 30 are as follows:

<b>(In thousands):</b>	<b>2007</b>	<b>2006</b>
Accretion of interest expense	\$ 6,082	\$ 6,663
Amortization of prepaid insurance	1,480	1,487
<b>Total</b>	<b>\$ 7,562</b>	<b>\$ 8,150</b>

In summary, the non-cash loss which is represented by the income from tax credits, less interest expense and amortization of prepaid insurance, for the six months ended June 30 is as follows:

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(In thousands):	2007	2006
Non-cash loss	\$ (4,941)	\$ (4,870)

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In addition, other interest relating to notes payable AI Credit, totaling \$64,000 and \$312,000, was incurred during the six month periods ended June 30, 2007 and 2006, respectively, and management fees, which were payable to Newtek and included as revenue in the corporate activities segment, totaled \$2,234,000 and \$2,721,000, for the six month periods ended June 30, 2007 and 2006, respectively.

Since the Company does not anticipate creating any new Capcos in the foreseeable future, we anticipate incurring losses going forward. Income from tax credits will consist solely of accretion of income from thresholds previously achieved since we have achieved all investment percentage thresholds as of December 31, 2006. We will continue to incur non-cash expenses consisting of accretion of interest expense and amortization of prepaid insurance on our existing Capcos.

**All Other**

The all other segment includes revenues and expense primarily from businesses formed from investments in qualified businesses made through Capco programs which cannot be aggregated with other operating segments. Revenues and expenses associated with Phoenix Development Group, LLC were reclassified to discontinued operations.

**For the three months ended June 30, 2007 and 2006:**

<b>(In thousands):</b>	<b>2007</b>	<b>2006</b>	<b>\$ Change</b>	<b>% Change</b>
Revenue	\$ 2,188	\$ 781	\$ 1,407	180 %
Expenses	(1,990)	(1,488)	(502)	(34)%
Income (loss) from continuing operations before minority interest, benefit for income taxes and discontinued operations	198	(707)	905	128 %
Minority interest	1		1	100 %
Income (loss) from continuing operations before benefit for income taxes and discontinued operations	\$ 199	\$ (707)	\$ 906	128 %

The revenue increase of \$1,407,000 for the three months ended June 30, 2007, as compared with 2006, is primarily due to the consolidation of CDS Business Services, Inc. for the first time, which generated \$474,000 of revenues for the quarter. Additionally, the Company recognized a gain on the sale of an investment in a qualified business of \$907,000 and recoveries on previously written off investments in qualified businesses of \$123,000. Insurance commissions increased by \$19,000, or 10%, to \$207,000 for the three months ended June 30, 2007 from \$188,000 for the three months ended June 30, 2006.

Income (loss) before benefit for income taxes increased by \$906,000 in 2007 to \$199,000 from \$(707,000) in 2006 primarily due to a gain on sale/recoveries of investments in qualified businesses of \$1,032,000 and an overall decrease in losses from other entities included in the All other segment, offset by a loss from CDS Business Services, Inc. of \$266,000 for the first time this quarter.

**For the six months ended June 30, 2007 and 2006:**

<b>(In thousands):</b>	<b>2007</b>	<b>2006</b>	<b>\$ Change</b>	<b>% Change</b>
Revenue	\$ 3,707	\$ 1,656	\$ 2,051	124 %
Expenses	(3,881)	(3,199)	(682)	(21)%
Loss from continuing operations before minority interest, benefit for income taxes and discontinued operations	(174)	(1,543)	1,369	89 %
Minority interest	1		1	100 %
Loss from continuing operations before benefit for income taxes and discontinued operations	\$ (173)	\$ (1,543)	\$ 1,370	89 %



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The revenue increase of \$2,051,000 for the six months ended June 30, 2007 as compared with 2006, is primarily due to the consolidation of CDS Business Services, Inc. for the first time, which generated \$1,026,000 of revenues for the period. Additionally, the Company recognized a gain on the sale of a qualified business of \$907,000 and recoveries on previously written off investments of \$123,000 and a one time gain on an investment of \$229,000 for the six months ended June 30, 2007 as compared to a one time gain of \$100,000 during the same period last year. Insurance commissions increased by \$13,000, or 3%, to \$445,000 for the six months ended June 30, 2007 from \$432,000 for the six months ended June 30, 2006.

Loss before benefit for income taxes decreased by \$1,370,000 in 2007 to \$(173,000) from \$(1,543,000) in 2006 primarily due to a loss from CDS Business Services, Inc. of \$415,000 for the first time this year, offset by a gain on sale/recoveries of investments in qualified businesses of \$1,032,000, a reduction of \$534,000 of losses incurred in 2006 from Where Eagles Fly, a Washington D.C. Capco investment and an overall decrease in losses from other entities included in the All other segment

**Corporate activities****For the three months ended June 30, 2007 and 2006:**

<b>(In thousands):</b>	<b>2007</b>	<b>2006</b>	<b>\$ Change</b>	<b>% Change</b>
Revenue	\$ 1,106	\$ 1,244	\$ (138)	(11)%
Expenses	(2,871)	(2,481)	(390)	(16)%
Loss from continuing operations before benefit for income taxes and discontinued operations	\$ (1,765)	\$ (1,237)	\$ (528)	(43)%

Revenue is derived primarily from management fees earned from the Capcos, which amount to 2.5% of certified capital. The management fee revenue is included in the segment revenues, but eliminated on the consolidated statement of operations. Management fee revenue totaled \$1,086,000 and \$1,221,000 for the three month period ended June 30, 2007 and 2006, respectively. If a Capco does not have current or projected cash sufficient to pay management fees then such fees are not accrued.

The decrease in management fee revenue of \$135,000 for the three months ended June 30, 2007 as compared with the three months ended June 30, 2006 is primarily attributable to less management fees being accrued for two New York capcos totaling \$244,000, offset in part by management fees being accrued in 2007 for the first time for one of our subsidiaries totaling \$115,000 for the quarter.

The \$522,000 increase in expenses in 2007 as compared to 2006 was primarily due to a \$588,000 increase in consulting, payroll, and benefits, a \$71,000 increase in other expenses, most of which are related to the consolidation of our New York City offices, offset, in part, by a \$285,000 decrease in professional fees and a \$45,000 decrease in insurance expense.

**For the six months ended June 30, 2007 and 2006:**

<b>(In thousands):</b>	<b>2007</b>	<b>2006</b>	<b>\$ Change</b>	<b>% Change</b>
Revenue	\$ 2,232	\$ 2,507	\$ (275)	(11)%
Expenses	(6,008)	(4,759)	(1,249)	(26)%
Loss from continuing operations before benefit for income taxes and discontinued operations	\$ (3,776)	\$ (2,252)	\$ (1,524)	(68)%

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Revenue is derived primarily from management fees earned from the Capcos, which amount to 2.5% of certified capital. The management fee revenue is included in the segment revenues, but eliminated on the consolidated statement of operations. Management fee revenue totaled \$2,435,000 and \$2,171,000 for the six month period ended June 30, 2007 and 2006, respectively. If a Capco does not have current or projected cash sufficient to pay management fees then such fees are not accrued.

The decrease in management fee revenue of \$264,000 for the six months ended June 30, 2007 as compared with the six months ended June 30, 2006 is due to less management fees being accrued for two New York capcos totaling \$487,000, offset in part by management fees being accrued in 2007 for the first time for one of our subsidiaries totaling \$230,000 for the period.

The \$1,249,000 increase in expenses in 2007 as compared to 2006 was primarily due to a \$1,224,000 increase in consulting, payroll, and benefits, a \$478,000 increase in other expenses which includes \$106,000 of expenses related to the consolidation of our New York City offices, offset, in part, by a \$472,000 decrease in professional fees and a \$73,000 decrease in insurance expense.

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 six months ended June 30, 2007 (In thousands)**

Business Services Segments						Total Business Services Segments	CAPCO Segment	Eliminations	Total
SBA Lending	Electronic Payment Processing	Web Hosting	All Other	Corporate Activities					
\$4,924	\$ 25,627	\$ 7,838	\$ 3,707	\$ 2,232	Net Revenue	\$ 44,328	\$ 3,356	\$ (2,464)	\$ 45,220
4,714	23,923	5,815	3,880	6,008	Total Expenses and minority interest	44,340	10,228	(2,464)	52,104
					Income (loss) before (provision) benefit for income taxes and discontinued operations	(12)	(6,872)		(6,884)
210	1,704	2,023	(173)	(3,776)	(Provision) benefit for income taxes	(502)	2,591		2,089
	(519)	(904)	(289)	1,210					
					Income (loss) before discontinued operations	(514)	(4,281)		(4,795)
210	1,185	1,119	(462)	(2,566)	Discontinued operations, net of taxes	(491)			(491)
			(491)						
210	1,185	1,119	(953)	(2,566)	Net income (loss)	(1,005)	(4,281)		(5,286)
					Non-Cash:				
					Income from tax credits		(2,621)		(2,621)
	519	763	14	(1,400)	Deferred income taxes	(104)	(2,591)		(2,695)
779	890	1,555	159	120	Depreciation and amortization	3,503	28		3,531
(504)					Capitalization of servicing assets	(504)			(504)
			(1,032)		Gain on sale/recoveries of investments in qualified businesses	(1,032)			(1,032)
					Accretion of interest expense		6,082		6,082
372					Provision for loan losses	372			372
					Gain on sale of loans held for investment	(93)			(93)
(93)					Other non-cash net	411	(280)		131
59		5	90	257					



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						Change in assets and liabilities:		
(577)						SBA loans originated over proceeds from sale of SBA loans	(577)	(577)
						Prepaid insurance	1,480	1,480
(1,757)						Restricted cash change	(1,757)	(1,757)
965	42	(213)	(1,020)	(83)		Other net	(309)	(191)
								(500)
						Net cash provided by (used in)		
\$(546)	\$ 2,636	\$ 3,229	\$ (2,742)	\$ (3,672)		operations	\$ (1,095)	\$ (2,374)
								\$ (3,469)

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Our operating businesses are dependent on the health of the small and medium-sized segments of the U.S. economy. The continuing rise in interest rates, along with the rise in gas and commodity prices, could have a negative impact on consumer spending which could adversely impact our customers. This could also negatively impact the value of commercial and residential real estate, which could adversely impact the loan portfolio of our SBA Lending segment.

**Critical Accounting Policies and Estimates:**

The Company's significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements included in its Form 10-K for the fiscal year ended December 31, 2006. 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, 2006. There have been no significant changes in the Company's existing accounting policies or estimates since its fiscal year ended December 31, 2006.

**Liquidity and Capital Resources**

(Dollars in thousands)

	<b>For the Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
Net cash used in operating activities	\$ (3,469)	\$ (2,395)
Net cash (used in) provided by investing activities	9,555	14,553
Net cash (used in) provided by financing activities	(4,756)	(8,660)
Net increase in cash and cash equivalents	1,330	3,498
Cash and cash equivalents, beginning of period	26,685	23,940
Cash and cash equivalents, end of period	\$ 28,015	\$ 27,438

Cash requirements and liquidity needs in 2007 and the foreseeable future are primarily funded through our capacity to borrow from our \$50 million GE line of credit to originate and warehouse the guaranteed and unguaranteed portion of loans of our SBA lending unit and available cash and cash equivalents. The availability of the lending facility is subject to the compliance with certain covenants and collateral requirements as set forth in the agreement. At June 30, 2007, our unused sources of liquidity consisted of unrestricted cash and cash equivalents of \$28,015,000 and \$5,311,000 available through the lending facility.

While Newtek is 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. Newtek believes its loan loss reserves, which are evaluated monthly on a loan by loan basis, along with its collateral monitoring practices are adequate. 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.

Our recent bids for the guaranteed portion of our loans have remained stable and the market for such portions remains active in the current environment. From time to time we may sell the un-guaranteed portion of our loans. We do not depend on such sales to fund our operations. Should the pricing for the un-guaranteed portions become less attractive and we elect not to sell them, funds available under our credit facility will be sufficient to permit us to make loans.

In addition, the Company held \$2,950,000 in U.S. Treasury Notes which are classified as held for sale and could be converted to cash and cash equivalents. Restricted cash totaling \$8,966,000 which is primarily held in the Capcos, can be used in managing and operating the Capcos, making qualified investments, to repay debt obligations and for the payment of income taxes.

Net cash provided by investing activities primarily includes the purchase or sale of fixed assets and customer accounts, activity regarding the unguaranteed portions of SBA loans and changes in restricted cash and investments. During 2007, cash was used to purchase \$1,659,000 in

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fixed assets primarily to support increased customers in our web hosting segment and to acquire \$166,000 in customer merchant accounts. A net increase in the unguaranteed portion of SBA loans increased cash by \$1,529,000. We also received net proceeds of \$4,066,000 through a reduction in restricted cash held by our Capcos, \$1,370,000 from the return of investments in qualified businesses, \$1,572,000 from the sale of asset held for sale and insurance recoveries, and proceeds of \$492,000 from the sale of an investment in a qualified business.

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Net cash used in financing activities primarily includes net repayments on notes payable of \$3,693,000, net borrowings on bank notes payable of \$2,954,000, and a \$2,050,000 reduction in restricted cash in CDS.

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 principal and interest payments on our debt.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Because Newtek Small Business Finance, Inc., our 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 \$14,740,000 outstanding on the GE line of credit as of June 30, 2007. Interest rates on such notes are variable at prime plus 0.25 or base 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 sharply rising interest rates, our cost of funds would increase, 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% for the second quarter of 2007. Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet, and other business developments that could effect 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.

Additionally, we do not have significant exposure to changing interest rates on invested cash and cash equivalents, restricted cash and U.S. Treasury notes which was approximately \$39,931,000 and \$42,976,000 as of June 30, 2007 and December 31, 2006, 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.

**Item 4. Controls and Procedures.**

- (a) **Evaluation of Disclosure Controls and Procedures.** As of the end of the period covered by this report, our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that our disclosure controls and procedures as of the end of the period covered by this report have been designed and are functioning effectively to provide reasonable assurance that the information we (including our consolidated subsidiaries) are required to disclose in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. However, because we had previously determined the existence of a material weakness in our disclosure controls and procedures as of December 31, 2005 and March 31, 2006, and despite the remediation efforts discussed below, and given the relatively short time since the remediation efforts have taken place, there can be no assurance that we have identified and corrected all matters which would constitute, or might lead to future, disclosure control weaknesses.
- (b) **Changes in Internal Controls.** We have placed significant emphasis on remediation of the previously disclosed material weakness and have added a senior legal officer responsible for internal control development and five professional positions in our accounting and finance staff during the quarters ended June 30, 2006, September 30, 2006 and December 31, 2006.
- (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. Further, 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



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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.

**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

We are not involved in any material pending litigation. We and/or one or more of our investee companies are involved in lawsuits regarding wrongful termination claims by employees or consultants, none of which are individually or in the aggregate material to Newtek.

**Item 2. Unregistered Sales of Equity Securities**

(a) On June 26, 2007, pursuant to the terms of the Company's directors' compensation program, the Company issued to its four independent directors a total of 24,147 unregistered common shares with a market valuation as of that date of \$46,128. The shares were issued in exchange for the services of the directors on the Board of Directors and its committees in reliance on Section 4(2) of the Securities Act of 1933, as amended.

(b) 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 June 30, 2007, the Company purchased 43,765 treasury shares under that authorization.

The following table summarizes the repurchase of common stock under the stock buy-back program:

Period	Total number of shares purchased (1)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the program
08-01-06 through 08-31-06	31,500	\$ 1.70	31,500	968,500
04-01-07 through 04-30-07	12,265	\$ 1.98	12,265	956,235

(1) All shares were purchased pursuant to the publicly announced Stock Buy-Back Program, which was effective as of March 2006 and has no set expiration. We are authorized to purchase up to 1 million shares of our common stock under the Program.

**Item 4. Submission of Matters to a Vote of Security Holders.**

(a) On May 30, 2007, we held our annual meeting of shareholders, at which there were present in person or by proxy 30,143,048, or 81.96%, of the outstanding common shares.

(b) All incumbent nominees for election as Class I directors were reelected to three year terms with votes as follows:

	FOR	WITHHELD
Salvatore F. Mulia	30,019,193	123,855
Jeffrey G. Rubin	30,020,193	122,455



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(c) The shareholders also voted for and approved the ratification of the selection of J. H. Cohn LLP as our Independent Registered Public Accounting Firm for the Company for the year ending December 31, 2007. The vote was:

For:	30,062,086 votes
Against:	19,065 votes
Abstained:	32,260 votes

**Item 6. Exhibits**

**Exhibit**

<b>No.</b>	<b>Description</b>
2.1	Asset Purchase Agreement, dated April 28, 2004, between Newtek Business Services, Inc., and CrystalTech Web Hosting, Inc. (including a listing of omitted schedules). (Incorporated by reference to Exhibit 2.1 to Newtek's Report on Form 8-K dated April 30, 2004.)
3.1	Certificate of Incorporation of Newtek Business Services, Inc., as revised and restated through November 21, 2005. (Incorporated by reference to Exhibit 3.1 to Newtek's Report on Form 10-K filed May 10, 2006.)
3.2	Bylaws of Newtek Business Services, Inc. (Incorporated by reference to Exhibit No. 3.2 to Registration Statement No. 333-115615.)
10.1	Employment Agreement with Barry Sloane, June 30, 2005. (Incorporated by reference to Newtek's Report on Form 10-K filed May 10, 2006.)
10.2	Employment Agreement with Jeffrey G. Rubin, June 30, 2005. (Incorporated by reference to Newtek's Report on Form 10-K filed May 10, 2006.)
10.3	Employment Agreement with Craig J. Brunet dated July 13, 2006. (Incorporated by reference to Exhibit 10.3 to Newtek's Report on Form 10-Q filed July 14, 2006.)
10.4	Lease Agreement dated March 15, 2007 between CrystalTech Web Hosting, Inc. and i/o Data Centers for Phoenix lease (Incorporated by reference to Exhibit 10.4 to Newtek's Report on Form 10-Q filed May 15, 2007.)
10.5	Fourth Amendment to the Amended and Restated Master Loan and Security Agreement, dated December 31, 2002 between Newtek Small Business Finance, Inc. and DB Structured Products, Inc., dated June 29, 2005. (Incorporated by reference to Exhibit 10.1 to Newtek's Report on Form 8-K, dated June 29, 2005.)
10.6	Credit Agreement between Newtek Business Services, Inc., Newtek Small Business Finance, Inc., Small Business Lending, Inc., CCC Real Estate Holding Co., LLC and General Electric Capital Corporation, dated August 31, 2005. (Incorporated by reference to Exhibit 10.1 to Newtek's Report on Form 8-K, filed September 6, 2005.)
10.7	First Amendment and Waiver to Credit Agreement, dated February 28, 2006, to the Credit Agreement dated August 31, 2005, between Newtek Business Services, Inc., the other credit parties signatory thereto and General Electric Capital Corporation. (Incorporated by reference to Exhibit 99.1 to Newtek's Report on Form 8-K, filed March 2, 2006.)
10.7.1	Second Amendment and Waiver to Credit Agreement, dated February 28, 2006, to the Credit Agreement dated December 28, 2006, between Newtek Business Services, Inc., the other credit parties signatory thereto and General Electric Capital Corporation. (Incorporated by reference to Newtek's Report on Form 10-K filed April 2, 2006.)



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- 10.8 Guaranty between Newtek Business Services, Inc. Small Business Lending, Inc., CCC Real Estate Holding Co., LLC and General Electric Capital Corporation, dated August 31, 2005. (Incorporated by reference to Exhibit 10.2 to Newtek's Report on Form 8-K, filed September 6, 2005.)
- 10.9 Credit and Security Agreement by and between CDS Business Services, Inc. and Wells Fargo Bank, National Association dated February 27, 2007.
- 10.9.1 Waiver under Credit and Security Agreement by and between CDS Business Services, Inc. and Wells Fargo Bank, National Association dated February 27, 2007.
- 31.1 Certification of the Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**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: August 14, 2007

By: /s/ Barry Sloane  
Barry Sloane  
Chairman of the Board, Chief Executive Officer and Secretary

Date: August 14, 2007

By: /s/ Michael J. Holden  
Michael J. Holden, Treasurer,  
Chief Financial Officer, Chief Accounting Officer

Date: August 14, 2007

By: /s/ Eyal Amsalem  
Eyal Amsalem  
Chief Accounting Officer and Controller