

NEWTEK BUSINESS SERVICES INC
Form 10-Q
November 14, 2005

**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2005

OR

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

Commission File Number: 001-16123

NEWTEK BUSINESS SERVICES, INC.

(Exact name of registrant as specified in its charter)

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

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

**462 Seventh Avenue, New York, New York
(Address of principal executive offices)**

**10018
(Zip Code)**

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

Check 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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of November 11, 2005, 34,629,175 Common shares were issued and outstanding.

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ITEM 1. FINANCIAL STATEMENTS

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004

(In Thousands except for Per Share Data)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2005	2004	2005	2004
Revenue:				
Electronic payment processing	\$ 8,435	\$ 5,126	\$ 21,955	\$ 12,430
Income from tax credits	5,905	11,421	17,303	20,469
Web hosting	2,769	2,204	7,680	2,204
Interest income	1,237	865	3,566	2,936
Premium fee income	827	607	3,345	3,073
Servicing fee income	539	402	1,477	1,190
Insurance commissions	273	391	991	391
Other income	477	582	3,683	1,258
Total revenue	20,462	21,598	60,000	43,951
Expenses:				
Electronic payment processing costs	6,143	3,598	16,094	8,729
Payroll and consulting fees	3,996	2,997	12,307	7,544
Interest	4,208	3,290	11,785	10,533
Professional fees	1,902	1,573	5,442	3,410
Depreciation and amortization	1,171	773	3,445	1,390
Insurance	856	738	2,319	2,145
Provision for loan losses	1,082	59	2,183	12
Goodwill impairment	822	—	822	—
Other than temporary decline in value of investments	321	—	321	—
Other	2,298	1,526	5,853	3,536
Total expenses	22,799	14,554	60,571	37,299
(Loss) income before minority interest, and benefit (provision) for income taxes	(2,337)	7,044	(571)	6,652
Minority interest	258	273	630	883
(Loss) income before benefit (provision) for income taxes	(2,079)	7,317	59	7,535
Benefit (provision) for income taxes	102	(3,000)	(948)	(3,089)
Net (loss) income	\$ (1,977)	\$ 4,317	\$ (889)	\$ 4,446
Net (loss) income per share:				
Basic	\$ (0.06)	\$ 0.13	\$ (0.03)	\$ 0.15

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Diluted	\$	(0.06)	\$	0.13	\$	(0.03)	\$	0.15
Weighted average common shares outstanding								
Basic		34,453,748		33,308,929		34,104,827		28,854,029
Diluted		34,453,748		33,420,377		34,104,827		29,247,416

See accompanying notes to these unaudited consolidated financial statements.

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2005 (UNAUDITED) AND DECEMBER 31, 2004
(In Thousands except for Share Data)

	September 30, 2005	December 31, 2004
A S S E T S		
Cash and cash equivalents	\$ 53,719	\$ 50,922
Restricted cash	2,871	2,182
Credits in lieu of cash	93,940	88,883
SBA loans receivable (net of reserve for loan losses of \$2,464 and \$1,621, respectively)	31,587	34,186
Accounts receivable (net of allowance of \$172 and \$72, respectively)	1,400	1,561
Receivable from bank	-	1,800
SBA loans held for sale	6,145	2,262
Accrued interest receivable	479	375
Investments in qualified businesses - cost method investments	100	300
Investments in qualified businesses -held to maturity debt investments	3,498	2,909
Structured insurance product	3,337	3,216
Prepaid insurance	16,522	15,505
Prepaid expenses and other assets (net of accumulated amortization of deferred financing costs and other intangibles of \$977 and \$404, respectively)	8,273	4,709
Servicing asset (net of accumulated amortization and allowances of \$1,286 and \$489, respectively)	2,658	2,085
Furniture, fixtures and equipment (net of accumulated depreciation and amortization of \$2,015 and \$1,026, respectively)	3,768	1,959
Customer accounts (net of accumulated amortization of \$2,493 and \$1,227, respectively)	6,287	4,394
Goodwill	8,671	11,150
Total assets	\$ 243,255	\$ 228,398
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Accounts payable and accrued expenses	\$ 8,827	\$ 9,726
Notes payable - certified investors	3,941	3,926
Notes payable - insurance	8,250	7,877
Notes payable - other	8,009	520
Bank notes payable	23,721	27,988
Deferred revenue	1,392	1,160
Notes payable in credits in lieu of cash	87,530	76,259
Mandatorily redeemable preferred stock	—	1,500
Deferred tax liability	17,759	16,626
Total liabilities	159,429	145,582
Minority interest	5,055	5,721
Commitments and contingencies		
Shareholders' equity:		

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Preferred stock (par value \$0.02 per share; authorized 1,000,000 shares, no shares issued and outstanding)	—	—
Common stock (par value \$0.02 per share; authorized 54,000,000 shares, issued and outstanding 34,534,499 and 33,873,333 not including 582,980 shares held in escrow)	691	677
Additional paid-in capital	55,280	52,858
Unearned compensation	(2,168)	(2,297)
Retained earnings	24,968	25,857
Total shareholders' equity	78,771	77,095
Total liabilities and shareholders' equity	\$ 243,255	\$ 228,398

See accompanying notes to these unaudited consolidated financial statements

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004
(In Thousands except for Share Data)

	2005	2004
Cash flows from operating activities:		
Net (loss) income	\$ (889)	\$ 4,446
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Income from tax credits	(17,303)	(20,469)
Deferred income taxes	1,133	3,089
Depreciation and amortization	2,828	1,106
Amortization of servicing asset	617	284
Provision for loan losses	2,183	12
Servicing asset valuation allowance	180	—
Other than temporary decline in value of investments	321	—
Goodwill impairment	822	—
SBA loans originated for sale	(36,098)	(23,191)
Proceeds from sale of SBA loans held for sale	32,215	24,918
Gain on sale of loans held for investment	(305)	(658)
Amortization of deferred loan origination fees, net	(151)	(45)
Accretion of interest income	(132)	(132)
Accretion of interest expense	9,336	8,696
Stock compensation	1,110	1,058
Minority interest	(630)	(883)
Equity in earnings in investee	(887)	—
Changes in assets and liabilities, net of purchase price reallocation:		
Prepaid insurance	(1,017)	404
Prepaid expenses and other assets, accounts receivable, receivable from bank and servicing assets	(3,071)	(2,836)
Accounts payable and accrued expenses	(237)	(539)
Net cash used in operating activities	(9,975)	(4,740)
Cash flows from investing activities:		
Investment in qualified businesses- held to maturity debt investments	(4,368)	(1,909)
Return of investments - held to maturity debt investments	3,658	1,614
Purchase of furniture, fixtures and equipment	(2,424)	(846)
Purchase of customer merchant accounts	(1,078)	—
SBA Loans originated for investment	(11,483)	(9,461)
Proceeds from sale of SBA loans held for investment	8,827	17,881
Payments received on SBA loans	3,528	7,660
Cash paid for acquisitions, net of cash received	—	(9,955)
Distribution from investee	820	—
Acquisition of minority interest resulting in goodwill	(100)	—
Contingent consideration for acquisition (Note 6)	(750)	—
Other investments	(36)	(30)
Net cash (used in) provided by investing activities	(3,406)	4,954

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004 (CONTINUED)
(In Thousands except for Share Data)

	2005	2004
Cash flows from financing activities:		
Proceeds from issuance of notes payable to certified investors	\$ 23,458	\$ 10,896
Cash paid for coverage A (syndication of notes)	(6,250)	(2,150)
Principal payments of note payable-insurance	(2,776)	(1,112)
Proceeds from note payable- other	8,014	—
Repayments of note payable - other	(525)	(360)
Repayments of mandatorily redeemable preferred stock	(1,500)	—
Change in restricted cash	(689)	415
Net repayments from SBA bank notes payable	(4,267)	(23,435)
Net proceeds from exercise of stock options	—	533
Net proceeds from issuance of common stock	713	22,164
Net cash provided by financing activities	16,178	6,951
Net increase in cash and cash equivalents	2,797	7,165
Cash and cash equivalents - beginning of period	50,922	33,445
Cash and cash equivalents - end of period	\$ 53,719	\$ 40,610
Supplemental disclosure of cash flow activities:		
Reduction of credits in lieu of cash and notes payable in credits in lieu of cash balances due to delivery of tax credits to Certified Investors	\$ 12,246	\$ 12,401
Issuance of notes in partial payment for insurance	\$ 3,000	\$ 3,000
Issuance of warrant in connection with purchase of Coverage A Insurance	\$ —	\$ 250
CrystalTech Final Purchase Price Allocations to Goodwill		
Additions to customer accounts	\$ 2,082	\$ —
Additions to intangibles	560	—
Additions to furniture and fixtures	375	—
Net deductions to goodwill	(3,258)	—
Net additions to assets and liabilities	241	—
Net effect on purchase price	\$ —	\$ —
Contingent consideration for acquisition (Note 6)	\$ 750	\$ —
Acquisition of minority interest resulting in goodwill:		
Newtek Business Services common stock issued	\$ —	\$ 786

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Less: minority interest acquired		—		—
Goodwill recognized	\$	—	\$	786
Conversion of minority interest to mandatorily redeemable preferred stock		—	\$	1,500

See accompanying notes to these unaudited consolidated financial statements.

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NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (Unaudited)

Basis of presentation and description of business

The unaudited consolidated financial statements of Newtek Business Services, Inc. and Subsidiaries (the “Company” or “Newtek”) included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and include all wholly- and majority-owned subsidiaries, and several portfolio companies in which the certified capital companies own non-controlling minority interest, 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 all minority holders.

Newtek is engaged in the business of providing financial products and business services to small- and medium-sized businesses through ownership and/or operation of specific primary lines of business as well as organizing certified capital companies (“Capco” or “Capcos”) and investing funds made available under the Capco programs in small businesses.

The unaudited consolidated financial statements of Newtek reflect, in the opinion of management, all adjustments necessary for a fair statement of financial position of Newtek at September 30, 2005, the results of operations for the three and nine months ended September 30, 2005 and 2004 and its cash flows for the nine months ended September 30, 2005 and 2004. Results of operations for the interim periods may not be representative of results to be expected for a full year. All adjustments are of a normal recurring nature.

Reference is made to the Company’s Annual Report on Form 10-K, as amended filed with the Securities and Exchange Commission for the year ended December 31, 2004, for a complete set of financial notes including the Company’s significant accounting policies.

The following is a summary of each Capco or Capco fund, state or jurisdiction of certification and date of certification:

Capco	State/Jurisdiction of Certification	Date of Certification
WA	New York	May 1998
WP	Florida	December 1998
WI	Wisconsin	October 1999
WLA	Louisiana	October 1999
WA II	New York	April 2000
WNY III	New York	December 2000
WC	Colorado	October 2001
WAP	Alabama	February 2004
WDC	District of Columbia	November 2004
WNY IV	New York	December 2004
WTX I	Texas	March 2005

In June 2005, Newtek funded its fourteenth Capco, Wilshire Texas Partners I, LLC (WTX I) for total certified capital of \$22,793,000. A second allocation in August 2005 added \$620,000 for total certified capital of \$23,413,000.

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NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) (Unaudited)

The State of Louisiana has four “capco funds” which are all a part of and consolidated with the WLA Capco. The second, Wilshire Louisiana Partners II, LLC (WLP II), and the third, Wilshire Louisiana Partners III, LLC (WLP III), were formed in October 2001, and October 2002, respectively. The fourth, Wilshire Louisiana Partners IV, LLC (WLP IV) was formed in October 2003.

In general, the Capcos issue debt and equity instruments, (“Certified Capital”), to insurance company investors (“Certified Investors”). The Capcos then make targeted investments (“Investments in Qualified Businesses”, as defined under the respective state statutes, or, “Qualified Businesses”) with the Certified Capital raised, which in most cases may be majority-owned or primarily controlled by the Capcos after the investments are consummated (excluding investments made by the Louisiana, Colorado, Texas and recent New York Capcos). Participation in each Capco program legally entitles the Capco to receive (or earn) tax credits from the state upon satisfying quantified, defined investment percentage thresholds and time requirements. In order for the Capcos to maintain their state-issued certifications, the Capcos must make Investments in Qualified Businesses in accordance with these requirements. These state requirements are mirrored in the limitations agreed to by each Capco in its written agreements with its Certified Investors and limit the activities of the Capcos to conducting the business of a Capco. Each Capco also has separate, legal contractual arrangements with the Certified Investors obligating the Capco to refrain from unauthorized activities, to use the proceeds from the notes only for Capco-authorized (i.e., “qualified”) investments, and to pay interest on the aforementioned debt instruments.

The Capco can satisfy the interest payment obligations, at the Capco’s discretion, by delivering tax credits in lieu of paying cash. The Capcos legally have the right to deliver the tax credits to the Certified Investors. The Certified Investors legally have the right to receive and use the tax credits and would, in turn, use these tax credits to reduce their respective state tax liabilities in an amount usually equal to 100% (WLA and WLP II, -110%) of their Certified investment. The tax credits can be utilized over a four to ten-year period at an annual percentage rate established by each separate Capco legislation, and in some instances are transferable and can be carried forward.

Restricted Cash

Under the terms of the prior agreement with Deutsche Bank, and the current agreement between Newtek Small Business Finance, Inc. (“NSBF”) and General Electric Capital Corporation, (“GE”), all payments received from NSBF’s borrowers are transferred into a restricted bank account. NSBF uses these funds to pay required principal and interest to the lender, amounts due to third party participants and certain other required payments. As of September 30, 2005 and December 31, 2004, restricted cash was \$2,871,000 and \$2,182,000 respectively.

Under the terms of the processing agreement between Universal Processing Services o