

NEWTEK BUSINESS SERVICES INC

Form 10KSB

March 31, 2003

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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-KSB

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

For the fiscal year ended December 31, 2002

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-16123

## NEWTEK BUSINESS SERVICES, INC.

New York

11-3504638

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(State or other jurisdiction of incorporation or organization)

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(I.R.S. Employer Identification No.)

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100 Quentin Roosevelt Boulevard Suite 408 Garden City NY

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11530

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(Address of principal executive offices)

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(Zip Code)

Registrant's telephone number, including area code: (516) 390-2260

### Securities Registered Pursuant to Section 12(b) of the Act:

Common Stock, par value \$0.02 per share

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(Title of class)

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

None

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained herein, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

State the issuer's revenues for its most recent fiscal year: \$34,624,151

## Edgar Filing: NEWTEK BUSINESS SERVICES INC - Form 10KSB

The aggregate market value of the voting stock held by non-affiliates of the registrant computed by reference to the price at which the common equity was sold on March 17, 2003, was approximately \$44,851,144.

As of March 17, 2003 there were 25,410,844 shares issued and outstanding of the registrant's Common Stock, par value \$0.02 per share.

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**PART I**

**Item 1. DESCRIPTION OF BUSINESS**

**The Company**

**Overview.** Newtek Business Services, Inc., which changed its name from that of Newtek Capital, Inc. in November 2002 in order to emphasize its current business objectives, is engaged in the business of

owning, operating or coordinating 8 businesses lines which serve small businesses and

organizing certified capital companies ( capcos ) and investing funds made available under the capco programs in small businesses including, those in which it holds an equity position.

During 2002, direct business operations of its businesses resulted in revenue of approximately \$4 Million or 12% of total revenue and the operation of the capcos resulted in non-cash revenues related to the capco tax credits of approximately \$30 Million, or 88% of total revenue. The chart on the following page depicts how these revenues are generated. During the same period, Newtek realized net income (exclusive of extraordinary gains) of approximately \$4.5 Million, substantially all of which is attributable to the non-cash income related to the capco programs.

Newtek is a New York corporation organized in 1999 in conjunction with the combination of the business of Newtek's predecessor, BJB Holdings, Inc., and REXX Environmental Corporation which at that time was traded on the American Stock Exchange.

**Business & Business Strategy.** Newtek's strategy is to operate the capcos and utilize resources available under the programs to develop businesses that emphasize serving other small businesses. During 2002 Newtek has reduced the number of business lines that it is investing in and operating and as of year-end Newtek is placing primary emphasis on 8 such lines. Services to small businesses which Newtek has emphasized during 2002 and expects to emphasize into the future include:

*Newtek Small Business Finance* -- small business loans available under programs of the United States Small Business Administration

*Newtek Merchant Solutions* -- small business electronic payment processing

*Newtek Financial Information Services* -- small business financial and management reporting and planning

*Newtek Business Exchange* -- small business brokerage and M & A services

*Newtek Tax Services* -- small business tax preparation services (currently being organized)

Secondary emphasis has been placed on the following:

*Newtek IT Services* -- software development and systems integration for small businesses

*Newtek Securities* -- small business capital formation assistance of a broker-dealer

*Newtek Strategies* -- small business strategic marketing planning and advice

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Newtek's business originated in 1998 and initially focused exclusively on developing income opportunities related to the capco programs. Through the end of 2002, it has established and/or manages 10 capcos or capco funds and provided the initial required capitalization for them of approximately \$3.8 Million. Conceived as venture capital funds, it has become very apparent both to Newtek and state governments, that additional funds through the capco programs are only one element of successful business strategies for new and growing small businesses. After its first year of operations, Newtek determined that it would take a hands-on approach to its investments and provide the other elements necessary for the businesses to survive and succeed. Through 2001 and 2002, this trend to greater participation in the businesses in which it has invested has led Newtek to the determination to focus on the types of businesses in which it will primarily (but not exclusively) invest, as described above, and to take a very active role in the management of these businesses.

Newtek continues to distinguish between its partner companies (those where it takes a greater role in ownership and management) and the other investments (those where it has a lesser role, or lesser equity or only a loan to the business). Marketing strategies have been developed during 2002 to enable the partner companies, operating in different markets and with overlapping but not identical ownership and management, to benefit from the unified market presence as a NEWTEK-branded business service or financial product.

Also during 2002 Newtek completed the acquisition of a company that manages an operating capco in New York and organized and arranged the funding for the ninth and tenth capcos under new legislation in Colorado and Louisiana.\* The entity that manages and owns a minority interest in the operating capco was acquired in January 2002 in an all stock transaction, Exponential, LLC, and was a partially-owned subsidiary of a private company, operating out of offices in Albany and Syracuse, New York. The net current asset value of Exponential is small but Newtek believes that the increased presence in the up-state New York region will be beneficial to its overall business.

Subsequent to a capco investment made in September 2002, in December Newtek added its own resources to those of its partner company and facilitated the acquisition of Commercial Capital Corporation, one of only 14 licensees of the US Small Business Administration permitted to originate SBA guaranteed loans nationwide. This company had made approximately \$370 Million in such loans since its inception in 1994, and held a current loan servicing portfolio of approximately \$196 Million including loans serviced for others of \$141 Million. Newtek has licensed the use of the Newtek brand name at no cost and the acquired company now operates as Newtek Small Business Finance. In conjunction with Newtek's participation in the acquisition, and its corporate guaranty, the principal warehouse lender for Commercial Capital, a Deutsche Bank affiliate, agreed to renew its \$75 Million revolving credit facility and agreed to exchange \$1.5 million of borrowings for \$1.5 Million in Commercial Capital's preferred stock in the lender. In addition, in January 2003, Newtek was instrumental in arranging for the strategic investment in Newtek Small Business Finance by an affiliate of Credit Suisse First Boston Corporation of an additional \$2 Million. This addition to the business of Newtek will greatly supplement the services which Newtek can provide to the small business market.

## **Certified Capital Companies - capcos**

\* In Louisiana, due to the structure of the capco legislation, Newtek has one capco which operates three separate funds. Because the funds are organized and funded separately, Newtek considers them and here refers to them as three separate capcos.

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**Overview.** A capco is either a corporation or a limited liability company, established in and chartered by one of the six states currently with authorizing legislation (Florida, Louisiana, Missouri, Colorado, New York and Wisconsin). Aside from seed capital provided by an organizer such as Newtek, a capco will issue debt and equity instruments exclusively to insurance companies, and the capcos then are authorized under the respective state statutes to make targeted acquisitions of interests in companies which may be majority-owned or primarily controlled by the capcos after the acquisition is consummated, and which may or may not be in conjunction with loans to such companies. In most cases, the tax credits provided by the states are equal to the amount of investment by the insurance companies in the securities of the capcos, which can be utilized by them over no less than ten years, or approximately 10% per year. These credits are unaffected by the returns or lack of returns on investments made by the capcos.

During 2002 Newtek established two new capcos or capco funds; Wilshire Colorado Partners, LLC which obtained approximately \$22.7 Million in funding in April 2002 and Wilshire Louisiana Partners III, LLC, which raised approximately \$8 Million in October 2002.

**The Role of Capcos in Newtek's Business Strategy.** Management of Newtek has determined that the features of the capco programs facilitate the use of the capco funds in the support of its development as a holding company for a network of small business service providers. The authorizing statutes in each of the states in which Newtek's capcos operate explicitly allow and encourage the capcos to take equity interests, which in some cases may include majority or controlling interests, in companies. Consequently, Newtek may, consistent with its business objectives, acquire interests in companies through its capcos and provide management and other services to these companies. The states objectives of job creation and economic development are unquestionably met, and since participation in these programs does not require or encourage short-term profitability, Newtek is able to use these funds in a patient manner. All of Newtek's current majority-owned companies are less than three years old, some are less than one year old, and all but one have produced a loss for 2002. Because of the nature of the capco program, Newtek may accept a normal level of start up loss, as it has the ability to devote the time, attention and resources to these companies which they require to become successful.

These capco programs are, in the view of Newtek's management, a complement to Newtek's long-term strategy of acquiring, developing and operating companies that provide business products and financial services to small businesses. Based upon the experience of its management, Newtek determined early in the operations of the capcos that the targeted new and small businesses required much more than just the funds available in the capcos. These businesses also require administrative, managerial, technical, legal and financial management assistance that Newtek provided in structuring and building the businesses. This hands-on management approach facilitates the general objectives of the capco programs of economic development, while at the same time permitting Newtek to develop its long-term investments.

Management of Newtek believes that it has built upon the resources of the capco programs to enhance the development of small businesses by significantly more than investing or loaning capco funds to an entrepreneur. Passive investment may have worked often enough in the business climate of the 1990's, but businesses today, particularly small businesses, require much more than funds to succeed. In order to make the capco investments successful, and thus to fulfill the public policy objectives of the capco programs, Newtek has attempted to take the next step with the active addition of management resources, technical and professional expertise and

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non-capco funds. This has included during 2002 the development of the zero-cost NEWTEK branding for the partner companies, as well as the material and significant assistance that Newtek provided to its partner company, Newtek Small Business Finance, in the negotiation of an extension of a \$75 Million credit line, which included an \$3 Million debt forgiveness and conversion of \$1.5 Million into preferred stock of the partner company. This was followed by the subsequent sale in January 2003 by the partner company of \$2 Million in preferred stock to a unit of Credit Suisse First Boston Corporation in conjunction with a referral agreement for lending business. These are good examples of the other types of possible benefits available to the partner companies by association with a larger business such as Newtek.

**The Capco Programs; Tax Credits.** The recognition of revenue by the capcos organized by Newtek at present represents the largest single source of revenue to the company, or approximately 88% of gross revenue in 2002. Such revenue is the principal contribution to Newtek's net income in 2002 and 2001.

In return for the capcos making investments in the targeted companies, the states provide tax credits that are available for use by insurance companies that provide the funds to the capcos. In order to maintain its status as a capco, and to avoid recapture or forfeiture of the tax credits, each capco must meet a number of specific investment requirements, including a minimum investment schedule. A final loss of capco status, that is decertification as a capco, could result in loss or possible recapture of the tax credit. Newtek's capcos have agreed with their funding insurance companies to provide, in the event of decertification, payments by the capco or, as described below, by the capco insurer to the insurance companies in the nature of compensatory payments, to replace the lost tax credits.

**Investment Requirements.** Each of the state capco programs has a requirement that a capco, in order to maintain its certified status, must meet certain investment requirements, both qualitative and quantitative benchmarks.

*Quantitative Requirements:* For example in the state of New York, a capco must invest at least 25% of its certified capital (the amount of the original funding of the capco by the insurance companies) by 24 months from the initial investment date, 40% by 36 months and 50% by 48 months. The minimum investment requirements and time periods, along with the related tax credit recapture requirements are set out in detail below. See, also, Management's Discussion and Analysis -Income from Tax Credits and Note 1 of Notes to Consolidated Financial Statements - Revenue Recognition.

*Qualitative Requirements:* These include limitations on the initial size of the recipients of the capco funds, including the number of their employees, the location within the respective state of the recipients and the recipients' commitment to remain therein for a specified period of time, the types of business conducted by the recipients, and the terms of the investments in the recipients. Most significant for Newtek's business is the fact that the capco programs generally do not pose any obstacle to investments in qualified businesses which result in significant, majority or, in some cases, controlling ownership positions. This enables Newtek to achieve both public policy objectives of the capco programs, of increasing the number of small businesses and job opportunities in the state, as well as its own objectives of developing a number of small business service companies which may become profitable and return a meaningful return both to Newtek's stockholders and to the local participants in the businesses. In addition, because the businesses that Newtek is building themselves provide needed, and in management's judgment cost effective, goods and services to other small businesses, the growth of this important segment of a state's economy may be accelerated

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*Enforcement of Requirements:* The various states, which administer these programs through their insurance, banking or commerce departments, conduct periodic reviews and on site examinations of the capcos in order to verify that the capcos have met applicable investment requirements and are otherwise acting in conformance with the statutes and rules. Capcos are required to maintain detailed records so as to demonstrate to state examiners compliance with all applicable requirements. A failure of a capco to meet one of the statutory minimum *quantitative* investment benchmarks within the time specified would constitute grounds for the loss of the capco's status, or its decertification, and the loss and recapture of some or all of the tax credits previously passed through the capco to its investors. A decertification of one of Newtek's capcos would have a material adverse effect on the business of Newtek in that it would require the capco insurer to make compensatory payments equal to the lost tax credits and would permit the insurer to assume control over the assets of the capco in order to cover its losses. See, also, -- Government Regulation; State Capco Regulations, below.

*Newtek's Record of Compliance:* As of the end of 2002, all of Newtek's capcos were in material compliance with all applicable requirements and four of the ten capcos had met their final, minimum 50 % thresholds. This achievement eliminates entirely the risk of decertification and tax credit recapture or loss for its insurance company investors in these capcos, and this represents approximately \$51.4 Million of tax credits, or about 35% of the tax credits associated with Newtek's capcos.

**Capco Insurance: Credit Defeasance & Credit Enhancement.** Newtek has purchased insurance to cover the risks associated with the operation of its capcos from a subsidiary of American International Group, Inc. (AIG), a well respected and AAA credit rated, international insurer. Under the terms of this insurance, which is for the benefit of the insurance company investors, the capco insurer assumes the obligation to repay the insurance companies the principal amount of their debt (the defeasance) as well as to make compensatory payments in the event of a loss of the availability of the related tax credits (the enhancement). In the event of a threat of or final decertification by a state, the capco insurer would be authorized to assume partial or complete control of the business of the particular capco so as to ensure compliance with investment or other requirements. This would likely avoid final decertification and the necessity of insurance or cash interest payments. However, control by the insurer would also result in significant disruption of the particular capco's business and likely result in significant financial loss to that capco. Decertification would also likely impair Newtek's ability to obtain certification for capcos in additional states as new legislation makes other opportunities available. The individual capcos are individually insured, and the assets of one are not at risk for the obligations of the others.

In addition, Newtek's capcos have the ability to borrow additional funds, that is, to increase the amount of their uncertified capital, but Newtek has no need for or anticipation of utilizing this capacity. Such an increase in non-certified capital by a capco would have no effect on tax credit income or investment benchmarks for the capco. The additional funds could, however, be invested in qualified investments and speed the achievement of the benchmarks.

In order to address this risk of decertification, which may generally be eliminated by meeting a 50% of capital investment threshold, Newtek's capcos have structured their investment program, consistent with safe and sound operations, so as to meet the investment benchmarks as early as possible. As of December 31, 2002, four of Newtek's capcos, Wilshire Advisers, LLC Wilshire Partners, LLC Wilshire New York Partners II, LLC and Wilshire Louisiana Partners II, LLC had exceed the 50% investment benchmarks and placed their tax credits



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beyond loss or recapture. The table below presents the dates and amounts paid for the capco insurance related to the defeasance: repayment of principal to the insurance company investors (Coverage A) and credit enhancement: the compensatory payments in the event of a loss of tax credits (Coverage B). There were no such insurance purchases made in 2001. See, also, Note 2 of Notes to Consolidated Financial Statements.

Capco	Date of Purchase	Premium Paid for Coverage A	Premium Paid for Coverage B
WA	November 1998	\$ 1,647,905	\$ 157,694
<b>Total 1998</b>		<b>\$ 1,647,905</b>	<b>\$ 157,694</b>
WP	April 1999	\$ 23,127,927	\$ 3,998,948
WLA	October 1999	\$ 9,175,844	\$ 2,193,741
WI	October 1999	\$ 9,086,227	\$ 2,352,786
<b>Total 1999</b>		<b>\$ 41,389,998</b>	<b>\$ 8,545,475</b>
WNYII	April 2000	\$ 5,019,803	\$ 504,745
WA	May 2000	\$ 661,432	\$ 160,068
WLPPII	October 2000	\$ 2,456,565	\$ 319,958
WNYIII	December 2000	\$ 29,052,790	\$ 4,137,438
<b>Total 2000</b>		<b>\$ 37,190,590</b>	<b>\$ 5,122,209</b>
Colorado	April 2002	\$ 11,654,021	\$ 3,604,978
WLPPIII	October 2002	\$ 2,859,644	\$ 1,089,134
<b>Total 2002</b>		<b>\$ 14,513,665</b>	<b>\$ 4,694,112</b>

Newtek manages a tenth capco, Exponential, LLC, which is not covered by capco insurance as are its other capcos. Exponential is structured differently than Newtek's other capcos.

**Newtek's Ability to Compete.** Newtek's business now requires it to compete at two basic levels. The capcos compete in their offerings with the three or four other capcos sponsored by various national financial organizations, as well as locally sponsored companies in one or another state. Newtek's management believes it has been successful in raising funds because of:

the manner in which it has structured the participation by the insurance companies;

the insurance which it has been able to obtain to cover any loss of the tax credits and the obligation to repay principal, resulting in a credit rating for the instruments of AAA;

the previous business experience of its principals;

the national marketing of its programs; and

the extensive contacts that its management has as a result of previous experience in the financial community.

Newtek has structured the capco securities as debt instruments and either warrants for participation in the equity of the particular capco or, during 2002, as a unit with shares of Newtek. Newtek's capco debt instruments have all been rated AAA or the equivalent by Standard and Poor or another nationally recognized rating agency. The debt instruments and the tax credits they are related to are in some but not all state programs transferable, but such a transfer would have no effect on Newtek. In the past the individual capcos issued warrants entitling the holders to between 4% and 20% of the equity of the particular capco at a nominal exercise price. During 2002, Newtek has negotiated the exchange of many of these warrants for stock of Newtek which has the effect of reducing or eliminating the minority interests in the

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capcos and permitting all of the profits or losses of the capcos investments to flow up to Newtek as the principal owner of the capcos. Future capco offerings will likely not include capco warrants as part of the debt offering and will likely include the sale of Newtek common stock.

In addition to competing for capco funds, which are integral to the current state of the business, Newtek and particularly its partner companies must also compete in a number of markets for the sale of services to other businesses. Newtek has narrowed the focus of its principal investments to that of 8 business lines. Each of these require the partner companies to compete not only against other suppliers in their particular state or region of the country, but also against suppliers operating on a national and even a multi-national scale. However, none of the markets in which the partner companies compete are dominated by a small number of companies which could materially effect the nature or terms of the competition. In addition, in many cases, the competitors which the partner companies face are not as able as are the partner companies to take advantage of changes in business practices due to technological developments and, by their large size, are unable to offer the personalized service that many small business owners and operators seem to want. Through the resources available in Newtek, the company is attempting to build the partner companies into successful and profitable ventures. In 2002, the first of the partner companies showed a net profit for the first time. Management of Newtek is focused on improving these results of operations.

**Principal Business Activities: Partner Companies**

**Majority-owned or Primarily Controlled Partner Companies.** Newtek refers to its partner companies as those companies in which it owns 50% or more of the outstanding voting securities, or majority-owned partner companies, and those companies in which it owns more than 25% but less than 50% of the outstanding securities, and exercises more control over Newtek than any other shareholder, or primarily controlled partner companies. Currently, fourteen (14) of the investments in partner companies are accounted for as consolidated subsidiaries and four (4) of the investments in the partner companies are accounted for under the equity method of accounting. Of these, two have thus far primarily engaged in business with other partner companies and the others are engaged in business with third parties. See Note 3 to Notes to Consolidated Financial Statements.

**Majority-owned Companies (accounted for under the consolidation method)**

At December 31, 2002, Newtek had 14 majority-owned partner companies, all of which were as a result of investments through the capco programs. The majority-owned companies are grouped below by their business lines:

Newtek Small Business Finance, Inc. SBA Holdings, Inc.

Newtek Merchant Solutions Universal Processing Services Wisconsin, LLC

Newtek Merchant Solutions Universal Processing Services, LLC (NY)

Newtek Merchant Solutions Universal Processing Services Louisiana, LLC

Newtek Merchant Solutions Universal Processing Services Colorado, LLC

Newtek Financial Information Systems of Florida Group Management Technologies, LLC

Newtek Financial Information Systems of Louisiana -- Group Management Technologies of Louisiana, LLC

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Newtek Strategies Harvest Strategies, LLC

Newtek Business Exchange Transworld Business Brokers of NY, LLC

Newtek Client Services Global Small Business Services, LLC

Newtek IT Services -- Advanced Internet Design & Applications, LLC

PPM Link, LLC operating as Newtek Securities, LLC

Exponential Business Development Corp.

DC Media, LLC

For these majority-owned partner companies, Newtek will generally actively direct much of their operations. These companies are described below and summary financial information is also provided for each in the charts below. See also, Management's Discussion and Analysis or Plan of Operation and Note 22 of the Notes to Consolidated Financial Statements.

**Newtek Small Business Finance, Inc. ( NSBF ).** This latest of Newtek's principal investments was a major transaction for the company and holds much potential for the future. John Cox, a former Deputy Administrator of the US Small Business Administration with over 30 years experience, and until September 2002 a director of Newtek, following his resignation from the board of Newtek, joined with another 25 year veteran of the SBA, Michael Dowd, and together they organized and initially capitalized what became NSBF. One of Newtek's New York capcos provided \$2 Million in capital and additional capital of \$3.5 Million was raised from other institutional sources of which 2 million was subsequent to December 31, 2002. NSBF and Newtek together acquired Comcap Holdings Corp., and its subsidiary Commercial Capital Corporation, closing on the last day of 2002. Commercial Capital had been an active participant in the SBA-guaranteed loan market, having originated about \$370 Million in loans and currently servicing about \$196 Million in loans including \$141 Million of loans serviced for others.

Newtek was able to bring significant internal and external resources to bear to the transaction, including the agreement to provide a corporate guaranty of NSBF's bank debt, and issuing 380,471 shares of its common stock as consideration for the acquisition (an additional 82,980 shares will be issued in the future if certain hurdles are met).

**Universal Processing Services - Wisconsin, LLC d/b/a Newtek Merchant Solutions of Wisconsin ( UPS-WI )** provides credit card, debit card, gift card and check processing services directly to merchants and also, on a wholesale basis, acts as a processor for merchants that are brought to it through unrelated, third-party marketing organizations. UPS-WI acquires the majority of its merchant-customers through agreements with independent sales organizations and associations throughout the country which then contract with UPS-WI to provide processing services, and UPS-WI pays these organizations and associations a percentage of the processing revenue derived from their respective merchants. UPS-WI assists merchants with their initial installation of equipment and initial and on-going service and any other special processing needs that they may have. UPS-WI is continuing to enter into additional independent sales agreements with organizations and associations and has grown its customer base significantly during 2002.

Since inception in June 2001, UPS-WI has experienced operating losses in each year of operations. These losses have been primarily related to general corporate overhead and compensation paid to employees of UPS-WI, which together have been greater than the revenues generated by the company on an annual basis. The company is currently adding approximately 125 customers per month and has reached a customer base of approximately 1,200 as of the end of 2002. Because of the growth experienced in 2002 and early in 2003, management of Newtek expects that this partner company may show positive cash flow and earnings by the end of 2003. In addition, the residual value of the current recurring revenue stream could, in the judgment of

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management, be readily sold at a price approximately equal to the company's accumulated losses.

**Universal Processing Services, LLC d/b/a Newtek Merchant Solutions of NY ( UPS )** organized in March 2001 and based in New York, markets check, credit and debit card processing services, as well as ancillary processing equipment and software to merchants who accept credit cards, debit cards, and other non-cash forms of payment, the company also markets its products to larger national merchants with multiple locations. In addition to marketing these services to local markets, UPS is currently establishing relationships with local and regional banks that do not offer their own merchant processing, to enable them to offer these services to their clients through UPS. UPS provides direct merchant processing services, ancillary processing equipment and other related services for merchants. UPS contracts for the actual processing services provided to its merchants through an agreement with another Newtek partner company, Universal Processing Services -- Wisconsin, LLC. UPS has steadily increased the number of merchants under contract and has therefore experienced a continued increase in its monthly residual payments that it receives.

Since inception UPS has experienced operating losses in each year of operations. These losses have been primarily attributable to general corporate overhead and compensation and commissions paid to employees of UPS, which together have historically been greater than the revenues generated by the company on an annual basis. As with UPS-WI, the recurring revenue stream created by the aggregation of processing customers will create a value to Newtek that could be significant.

**Universal Processing Services - Louisiana, LLC d/b/a Newtek Merchant Solutions of Louisiana ( UPS-LA )** is engaged in the same business line as the previous partner company, UPS in New York. It too, has experienced a steady but slow growth in its customer base since beginning operations in September 2001. Since inception UPS-LA has experienced operating losses in each year of operations. These losses have been primarily attributable to general corporate overhead and compensation and commissions paid to employees of UPS, which together have historically been greater than the revenues generated by the company on an annual basis.

**Universal Processing Services - Colorado, LLC d/b/a Newtek Merchant Solutions of Colorado ( UPS-CO )** is based in Colorado was a start-up in December 2002 and is engaged in the same business line as the previous partner companies, UPS in New York and UPS-LA. As a start-up, this Company has had no significant business during 2002.

**Harvest Strategies, LLC d/b/a Newtek Strategies ( Harvest )** based in New York provides business development and outsourced management services to small and medium sized businesses. While many startup companies have viable products and services with exciting potential, history has confirmed that most will fail in a short period of time due to their lack of management expertise. Unlike management consulting firms that leave it to management to implement their suggestions, Harvest is distinguished by rolling up its sleeves and executing the plan as a true operating partner. In addition, its principals have experience in assisting companies implement large scale strategies. Harvest is a provider of outsourced executive management and strategic business development and implementation services to startup and early stage businesses. This portion of the market of smaller businesses is, in the judgment of

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management, largely untouched by the large management consulting firms that are strictly focused on Fortune 1000 companies.

Harvest's areas of expertise include sales and marketing, strategy formulation and implementation, financial services, internal control analysis and information technology consulting in the areas of operations and systems management. Upon engagement of Harvest as a strategic partner, each client undergoes a comprehensive and detailed evaluation to determine the appropriate level of involvement by Harvest. Factors considered in this assessment include:

- the overall viability, short and long term, of the client's business;
- the market positioning of the client's product and/or service;
- the client's business planning capabilities in the areas of marketing, sales and sales management, margin management human resources and technical support;
- the core competencies, skill sets and management skills needed to accomplish goals and objectives; and
- the financial controls and corporate governance policies in place.

Harvest is most frequently retained to assist businesses in the following areas:

- business plan formulation and implementation;
- identification and execution of strategic business initiatives;
- corporate governance assistance that formally sets forth all the appropriate board, management and legal policies;
- financial management;
- development of product offerings, and recommendations concerning sales and marketing initiatives;
- investor relations management;
- recruitment and training of employees; and
- participation in client board meetings as requested.

Since inception Harvest has experienced operating losses in each year of operations. These losses have been primarily attributable to relatively large general corporate overhead and the necessary compensation paid to its employees, which together have historically been greater than the revenues generated. Harvest has been working to improve its gross margins by engaging in consulting agreements with clients that it believes will deliver higher gross margin percentages, providing additional services to existing clients and better overall utilization of its corporate resources and employee productivity.

**Transworld Business Brokers of New York, LLC ( Transworld NY ) d/b/a Newtek Business Exchange of New York** is based in New York and provides brokerage and consulting services in the purchase and sale of small and medium-sized businesses. Transworld NY focuses on marketing its services to businesses with annual sales between 1 Million to 20 Million Dollars. Since Newtek's original investment in March 2002, Transworld NY has gone through management changes and has experienced operating losses since its inception. These losses have been primarily attributable to general corporate overhead and compensation paid to employees, which together have historically been greater than the revenues generated by the company on an annual basis.

**Group Management Technologies, LLC ( GMT ) d/b/a Newtek Financial Information Systems of Florida** is based in Florida and provides administrative and technological support for small businesses by designing and implementing specialized financial and management reporting systems and by providing outsourced financial management functions

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that reduce costs and management requirements for its clientele. GMT targets the market segment of businesses that are too small to afford a full time financial executive, but have grown to the point where managerial and financial controls must be introduced in order to grow the business to the next level. GMT's specialists work closely with management to create budgets and forecasts that serve as planning tools as well as performance evaluation and control benchmarks.

Since inception in November 1999, GMT has experienced operating losses in each year of operations. These losses have been primarily attributable to general corporate overhead and compensation and commissions paid to employees of GMT, which together have historically been greater than the revenues generated by the company on an annual basis.

**Group Management Technologies of Louisiana, LLC ( GMT-LA ) d/b/a Newtek Financial Information Systems of Louisiana** was organized in December 2002 and is based in Louisiana; it is engaged in the same line of business as is GMT. Management anticipates that in the future GMT-LA will contract with GMT for some of the services that are supplied to its clients. Since inception GMT-LA has experienced losses of which the majority are related to the start up expenses of the company.

**Global Small Business Services, LLC ( Global ) d/b/a Newtek Client Services** is based in Florida. The Company was organized in June 2002 and provides marketing and database management services to small and mid-sized businesses. Services provided include direct mail, direct response, inbound and outbound targeted telephone marketing and marketing consultation on program design and development. Since inception Global has experienced losses of which the majority are related to the start up expenses of the company.

**Advanced Internet Design & Applications, LLC ( AIDA ) d/b/a Newtek IT Services** was organized in western New York in 2000 and sells services to fulfill the need of small businesses for internet website creation, design and hosting. In particular, AIDA provides integrated and marketing internet portals on a project basis for small businesses. Newtek originally had high expectations for this company, but the developments in this area of business have made the ability of small companies to market such services profitability much more difficult. AIDA has experienced operating losses since inception. Newtek has narrowed the focus of the business and is exploring other ways in which it can improve the results of its operations.

**PPM Link, LLC ( PPM Link )** based in New York City and operating through its subsidiary **Newtek Securities, LLC**, raises equity capital and debt for its clients, which are predominately small to mid sized businesses which need financing for the implementation of their business plan. PPM Link owns Newtek Securities, a broker dealer registered with the National Association of Security Dealers, and placed most efforts during 2002 into building a data base of potential investors. Newtek Securities began in 2002 to market its services as a placement agent for the securities of businesses across a number of industries. In 2002 these have included companies that focus on the specialty finance industry, the gaming industry and the transportation industry. Only one transaction has been completed through December 31, 2002.

Since inception in March 2001, PPM Link has experienced operating losses in each year of operations. These losses have been primarily attributable to general corporate overhead and

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compensation and commissions paid to employees of PPM Link, which together have historically been greater than the revenues generated. In addition, general economic and market conditions during the past year have made raising money for small and mid-sized companies quite difficult, and this has had a negative effect on the performance of PPM Link.

**Exponential Business Development Company, Inc.** ( Exponential ) was originally organized in the mid-1990s to participate in the New York State capco program (effectively, a competitor of Newtek). It had structured its capco (Exponential, LLC) transactions differently than has Newtek with ownership being sold to the insurance company investors and a small equity portion retained by Exponential, the manager. The capco has made 11 small equity investments and 3 additional investments of both debt and equity. Exponential has also organized another investment vehicle (Exponential of New York, LP) that has made 6 equity investments and two others involving debt. Newtek's interest in this acquisition was due to the high reputation of the individuals participating in the company and the ability to identify and make investments in the northern and western areas of New York State.

**DC Media Finance, LLC** was organized in mid 2002 to engage in the business of providing financing necessary for a number of small businesses attempting to market a product through direct response television advertising. This niche product enables such manufacturers or distributors to obtain financing specifically structured for the acquisition of media time with repayment also structured for the requirements of that function. DC Media has completed one financing transaction and has shown a loss in its first half year of operations.

The unaudited summary financials for the partner companies accounted for as consolidated subsidiaries follow. These financial statements also reflect the degree to which Newtek's partner companies interact with each other to provide and market needed goods or, particularly, services from each other. The income from services provided to other partner companies is shown as Intercompany Eliminated Revenue and the cost of services acquired from other partner companies is shown as Intercompany Eliminated Expenses. All such inter-partner company transactions were conducted on terms and conditions no less favorable to each party than those available from third parties. See also Note 22 to the Notes to the Consolidated Financial Statements.

**CONSOLIDATED ENTITIES**

	Newtek Strategies (Harvest)		Newtek Merchant Solutions CO (UPC-CO)		Newtek Merchant Solutions NY (UPS)		Newtek Merchant Solutions LA (UPS-LA)		Newtek Merchant Solutions WI (UPS-WI)	
	2002	2001	2002	2001	2002	2001	2002	2001	2002	2001
Cash	\$ 256,233	\$ 1,638,703	\$ 3,248,403	(a)	\$ 18,611	\$ 2,969,784	\$ 705,617	\$ 1,259,089	\$ 445,686	\$ 1,798,864
Other Assets	\$ 207,801	\$ 117,588	\$ 2,662	(a)	\$ 417,956	\$ 486,632	\$ 26,485	\$ 19,251	\$ 254,444	\$ 46,722
<b>Total Assets</b>	<b>\$ 464,034</b>	<b>\$ 1,756,291</b>	<b>\$ 3,251,065</b>	<b>(a)</b>	<b>\$ 436,567</b>	<b>\$ 3,456,416</b>	<b>\$ 732,102</b>	<b>\$ 1,278,340</b>	<b>\$ 700,130</b>	<b>\$ 1,845,586</b>
Current Liabilities	\$ 33,006	\$ 53,026	\$ 14,433	(a)	\$ 108,554	\$ 51,630	\$ 29,729	\$ 7,251	\$ 118,670	\$ 19,174
<b>Total Liabilities</b>	<b>\$ 33,006</b>	<b>\$ 1,002,978</b>	<b>\$ 14,433</b>	<b>(a)</b>	<b>\$ 584,112</b>	<b>\$ 3,451,640</b>	<b>\$ 29,729</b>	<b>\$ 7,251</b>	<b>\$ 1,588,670</b>	<b>\$ 1,909,074</b>
<b>Total Equity (Deficit)</b>	<b>\$ 431,028</b>	<b>\$ 753,313</b>	<b>\$ 3,236,632</b>	<b>(a)</b>	<b>\$ (147,545)</b>	<b>\$ 4,776</b>	<b>\$ 702,373</b>	<b>\$ 1,271,089</b>	<b>\$ (888,540)</b>	<b>\$ (63,488)</b>

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**CONSOLIDATED ENTITIES**

	PPM Link		Exponential Business Development Co., Inc.		Newtek Small Business Finance (NSBF)		Newtek IT Services (AIDA)		Newtek Financial Information Systems FL (GMT)	
	2002	2001	2002	2001	2002	2001	2002	2001	2002	2001
Cash	\$ 1,254,506	\$ 1,700,109	\$ 41,973	\$ 106,642	\$ 4,367,870	(a)	\$ 2,372	3,835,404	\$ 70,034	17,799
Other Assets	\$ 61,686	\$ 130,558	\$ 25,551	\$ 41,372	\$ 59,296,476	(a)	\$ 64,910	170,464	\$ 131,985	113,438
<b>Total Assets</b>	<b>\$ 1,316,192</b>	<b>\$ 1,830,667</b>	<b>\$ 67,524</b>	<b>\$ 148,014</b>	<b>\$ 63,664,346</b>	<b>(a)</b>	<b>\$ 67,282</b>	<b>4,005,868</b>	<b>\$ 202,019</b>	<b>131,237</b>
Current Liabilities	\$ 1,069,144	\$ 46,553	\$ 59,996	\$ 57,350	\$ 2,704,417	(a)	\$ 103,655	60,673	\$ 44,809	13,795
<b>Total Liabilities</b>	<b>\$ 1,919,144</b>	<b>\$ 1,896,553</b>	<b>\$ 59,996</b>	<b>\$ 57,350</b>	<b>\$ 58,028,909</b>	<b>(a)</b>	<b>\$ 158,260</b>	<b>3,575,323</b>	<b>\$ 194,809</b>	<b>188,449</b>
<b>Total Equity (Deficit)</b>	<b>\$ (602,952)</b>	<b>\$ (65,886)</b>	<b>\$ 7,528</b>	<b>\$ 90,664</b>	<b>\$ 5,635,437</b>	<b>(a)</b>	<b>\$ (90,978)</b>	<b>430,545</b>	<b>\$ 7,210</b>	<b>(57,212)</b>

**CONSOLIDATED ENTITIES**

	Newtek Financial Information Systems LA (GMT-LA)		Newtek Business Exchange of NY (Transworld NY)		Newtek Client Services (Global)		DC Media Finance		Totals	
	2002	2001	2002	2001	2002	2001	2002	2001	2002	2001
Cash	\$ 284,000	(a) \$	3,186,239	(a) \$	2,377,662	(a)	\$ 344,293	(a)	\$ 16,603,499	\$ 13,326,394
Other Assets	\$ 500	(a) \$	55,005	(a) \$	1,415	(a)	\$ 385,063	(a)	\$ 60,931,939	\$ 1,126,025
<b>Total Assets</b>	<b>\$ 284,500</b>	<b>(a) \$</b>	<b>3,241,244</b>	<b>(a) \$</b>	<b>2,379,077</b>	<b>(a)</b>	<b>\$ 729,356</b>	<b>(a)</b>	<b>\$ 77,535,438</b>	<b>\$ 14,452,419</b>
Current Liabilities	\$ 11,373	(a) \$	21,089	(a) \$	0	(a)	\$ 92,226	(a)	\$ 4,411,101	\$ 309,452
<b>Total Liabilities</b>	<b>\$ 11,373</b>	<b>(a) \$</b>	<b>346,089</b>	<b>(a) \$</b>	<b>0</b>	<b>(a)</b>	<b>\$ 736,003</b>	<b>(a)</b>	<b>\$ 63,704,533</b>	<b>\$ 12,088,618</b>
<b>Total Equity (Deficit)</b>	<b>\$ 273,127</b>	<b>(a) \$</b>	<b>2,895,155</b>	<b>(a) \$</b>	<b>2,379,077</b>	<b>(a)</b>	<b>\$ (6,647)</b>	<b>(a)</b>	<b>\$ 13,830,905</b>	<b>\$ 2,363,801</b>

**CONSOLIDATED ENTITIES**

	Newtek Strategies (Harvest)		Newtek Merchant Solutions CO (UPC-CO)		Newtek Merchant Solutions NY (UPS)		Newtek Merchant Solutions LA (UPS-LA)		Newtek Merchant Solutions WI (UPS-WI)	
	2002	2001	2002	2001	2002	2001	2002	2001	2002	2001
Revenue	\$ 558,119	\$ 167,256	\$ 215	(a)	\$ 417,826	\$ 219,809	\$ 67,967	1,765	\$ 1,180,648	\$ 29,407
SG&A	835,247	393,976	72,258	(a)	631,432	259,092	547,589	80,676	1,903,475	39,340
Depreciation and Amortization	8,886	488	0	(a)	43,564	1,818	2,974	0	11,761	11,761
Interest expense	35,624	19,479	0	(a)	30,188	154,123	0	0	84,875	41,854
<b>Income/Loss</b>	<b>(321,638)</b>	<b>(246,687)</b>	<b>(72,043)</b>	<b>(a)</b>	<b>(287,358)</b>	<b>(195,224)</b>	<b>(482,596)</b>	<b>(78,911)</b>	<b>(819,463)</b>	<b>(63,548)</b>

**INTERCOMPANY ITEMS INCLUDED IN ABOVE**

Revenue	404,612	78,179	15		42,129	2,394	11,984	0	31,964	
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SG&A	45,842	12,649	95	138,180	54,054	92,399	12,522	149,422	1,574
Interest Expense	35,625	19,479	0	30,188	154,123		(a)	84,875	41,854

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**CONSOLIDATED ENTITIES**

	PPM Link		Exponential Business Development Co., Inc.		Newtek Small Business Finance (NSBF)		Newtek IT Services (AIDA)		Newtek Financial Information Systems FL (GMT)	
	2002	2001	2002	2001	2002	2001	2002	2001	2002	2001
Revenue	\$ 367,604	\$ 35,000	\$ 223,160	\$ 253,160	\$ 0	(a)	\$ 393,679	\$ 257,437	\$ 521,154	\$ 281,319
SG&A	677,601	361,449	305,496	200,973	0	(a)	818,988	541,941	577,609	722,649
Depreciation and Amortization	875	159	800	800	0	(a)	10,152	7,440	22,194	9,977
Interest expense	97,510	80,367	0	0	0	(a)	53,237	151,537	8,076	54,712
Income/Loss	(408,382)	\$ (406,975)	(83,136)	51,387	0	(a)	(488,698)	(443,481)	(86,725)	(506,019)
INTERCOMPANY ITEMS INCLUDED IN ABOVE										
Revenue	175,218	15,000				(a)	41,401	41,045	304,872	53,704
SG&A	36,923	8,690				(a)	102,741	42,565	34,352	28,154
Interest Expense	97,510	80,367				(a)	53,050	150,937	8,076	54,712

**CONSOLIDATED ENTITIES**

	Newtek Financial Information Systems LA (GMT-LA)		Newtek Business Exchange of NY (Transworld NY)		Newtek Client Services (Global)		DC Media Finance		Totals	
	2002	2001	2002	2001	2002	2001	2002	2001	2002	2001
Revenue	\$ 0	(a)	\$ 0	(a)	\$ 0	(a)	\$ 46,668	(a)	\$ 3,777,040	\$ 1,245,153
SG&A	11,373	(a)	195,996	(a)	62,236	(a)	102,893	(a)	6,742,193	2,600,096
Depreciation and Amortization	0	(a)	6,630	(a)	133	(a)	14,166	(a)	122,135	32,443
Interest expense	0	(a)	6,649	(a)	0	(a)	18,350	(a)	334,509	502,072
Income/Loss	(11,373)	(a)	(209,275)	(a)	(62,369)	(a)	(88,741)	(a)	(3,421,797)	(1,889,458)
INTERCOMPANY ITEMS INCLUDED IN ABOVE										
Revenue	0	(a)		(a)		(a)		(a)	836,962	197,166
SG&A	0	(a)	37,900	(a)	37,900	(a)	7,717	(a)	672,110	132,280
Interest Expense	0	(a)	6,094	(a)	6,094	(a)	3,573	(a)	318,992	501,472

(a) Not in existence or prior to acquisition

**Primarily Controlled Companies (accounted for under the equity method)**

At December 31, 2002, Newtek had four primarily controlled partner companies, all of which were as a result of investments through the capco programs. For primarily-controlled partner companies, Newtek will generally have significant involvement in and influence over their operating activities, including rights to participate in material management decisions. A description of these partner companies and a summary of their financial results follows. See also Management's Discussion and Analysis and Note 22 to the Consolidated Financial Statements.

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**Starphire Technologies, LLC, ( Starphire )**, located in Clearwater, Florida, was organized to provide information technology and electronic commerce services to small and mid-sized companies, including both software development and consulting services. Starphire's flagship product, SiteSage™ is a suite of web-site development, deployment and management software, consisting of an editing environment from which technical users can build custom applications and non-technical users can manage site content quickly and efficiently. Newtek monitored this partner company closely over its first two years of operations and determined late in 2002 that the resources and capital to Starphire would be insufficient to permit it to compete effectively in a very dynamic market with major, well funded competitors. As a result, the decision was made to wind-down operations and focus on providing hardware and software products and services provided by other larger scale providers. Starphire and Newtek are currently exploring a strategic alliance, joint venture or private labeling arrangement which would permit the company to market the services, which are in clear demand by small businesses, of a larger company under the Newtek small business brand.

**NicheDirectories, LLC, ( Niche )**, a Florida-based company, was founded in 1995. Niche is an online service provider and informational directory for the summer camp industry. KidsCamps.com ([www.kidscamps.com](http://www.kidscamps.com)) their flagship brand, is an online directory for information on over 1,400 summer camps and experiences for children. The company entered into a joint marketing agreement with MBNA America Bank, N.A. to provide what management believes to be the first consumer credit facility specifically designed to finance children's tuition for summer camp and related recreational and educational programs. The company also publishes CampJobs.com ([www.CampJobs.com](http://www.CampJobs.com)), a job posting site for the camping industry, GrownUpCamps.com ([www.GrownUpCamps.com](http://www.GrownUpCamps.com)), a directory for recreational and instructional programs for adults, RetreatSearch.com ([www.RetreatSearch.com](http://www.RetreatSearch.com)), an online directory of alternative meeting sites for seminars, reunions and picnics, and the e-commerce sites CampersMall.com. and CampDirectorsMall.com. Newtek has also been instrumental in assisting Niche enter into an agreement with American International Group for the marketing of specialized insurance products to camp operators and attendees. Niche management believes that at present it is the most popular internet site for camp related information.

**Transworld Business Brokers, LLC ( TWBB )** based in Florida, is engaged in the marketing and sale of small to medium-sized businesses and serves as a consultant in mergers and acquisitions of companies in this size range. TWBB specializes in dealing with businesses in several categories including the automotive, distribution, restaurant, manufacturing, medical, retail, service, and franchise industries. TWBB's revenue in 2001 exceed \$1 Million and in 2002 grew to \$2.2 Million. The company was profitable in 2002 having brokered over 300 business transactions since inception in 2000. The company's goals include maintaining increased revenues and profitability, and to geographically expand to include all of Florida and neighboring states, and to introduce new technological methods of evaluating and facilitating transactions, and eventually to establish a dominant presence as a business broker on a national basis.

**Copia Technology Services, LLC ( Copia )** is a Wisconsin-based company recently organized to provide billing management services. Newtek's equity interest in Copia was obtained through a merger of into it of CB Real Net, LLC (a former Newtek partner company which was not successful) Copia was organized late in 2002 and as yet has no employees or assets. Newtek management and the organizers of Copia are currently working on designing projects that would provide outsourced services to municipalities for the collection and payment

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of parking and traffic violations. Because it is initiating operations, no summary financial statements are shown below for this company.

The former partner company, **CB Real Net, LLC**, had been organized to provide the design and implementation of a technology platform for an affiliated entity which was in the process of establishing a real estate franchise network in Europe, which for various reasons unrelated to the performance of Newtek's partner company was unsuccessful. Newtek's capco had made a loan of \$2.5 Million and taken a 20% equity participation in CB Real Net; principal and interest on the loan was paid in full and thereafter the company was merged into Copia, in which Newtek retains its 20% interest.

The summary financials for these Partner companies accounted for through the equity method follow. These unaudited summary financial statements also reflect the degree to which Newtek's partner companies interact with each other to provide and market needed goods or, particularly, services from each other. The income from services provided to other partner companies is shown as Intercompany Eliminated Revenue and the cost of services acquired from other partner companies is shown as Intercompany Eliminated Expenses. All such inter-partner company transactions were conducted on terms and conditions no less favorable to each party than those available from third parties. See also Note 22 to the Notes to the Consolidated Financial Statements.

**ENTITIES UNDER THE EQUITY METHOD (a)**

	Starphire		Niche Directories		Transworld Business Brokers FL		Totals	
	2002	2001	2002	2001	2002	2001	2002	2001
Cash	\$ 14,653	\$ 1,352,823	\$ 212,409	\$ 556,741	\$ 153,087	\$ 245,515	\$ 380,149	\$ 2,155,079
Other Assets	402,874	460,508	288,093	273,328	328,261	334,854	1,019,228	1,068,690
<b>Total Assets</b>	<b>\$ 417,527</b>	<b>\$ 1,813,331</b>	<b>\$ 500,502</b>	<b>\$ 830,069</b>	<b>\$ 481,348</b>	<b>\$ 580,369</b>	<b>\$ 1,399,377</b>	<b>\$ 3,223,769</b>
Current Liabilities	\$ 34,330	\$ 85,652	\$ 438,915	\$ 354,861	\$ 53,990	\$ 22,457	\$ 527,235	\$ 462,970
<b>Total Liabilities</b>	<b>\$ 34,330</b>	<b>\$ 1,085,652</b>	<b>\$ 484,850</b>	<b>\$ 354,861</b>	<b>\$ 168,990</b>	<b>\$ 262,457</b>	<b>\$ 688,170</b>	<b>\$ 1,702,970</b>
<b>Total Equity (Deficit)</b>	<b>\$ 383,197</b>	<b>\$ 727,679</b>	<b>\$ 15,652</b>	<b>\$ 475,208</b>	<b>\$ 312,358</b>	<b>\$ 317,912</b>	<b>\$ 711,207</b>	<b>\$ 1,520,799</b>

(a) Copia Technology Services, LLC omitted due to lack of operations since inception in 2002.

**Table of Contents****ENTITIES UNDER THE EQUITY METHOD (a)**

	Starphire		Nichedirectories		Transworld Business Brokers FL		Totals	
	2002	2001	2002	2001	2002	2001	2002	2001
Revenue	\$ 122,782	\$ 359,675	\$ 754,043	\$ 614,701	\$ 2,237,869	\$ 1,066,495	\$ 3,114,694	\$ 2,040,871
SG&A	426,476	1,073,104	1,123,519	1,194,716	2,220,955	1,092,394	3,770,950	3,360,214
Depreciation and Amortization	28,252	30,863	20,214	16,453	2,445	505	50,911	47,821
Interest expense	12,451	28,156	1,194		10,125	6,000	23,770	34,156
Income/Loss	(344,397)	(772,448)	(390,884)	(596,468)	4,344	(32,404)	(730,937)	(1,401,320)
INTERCOMPANY ITEMS INCLUDED IN ABOVE								
Revenue	(17,127)	73,397					(17,127)	73,397
SG&A	28,578	46,107	66,908	1,014	21,740	8,028	117,226	55,149
Interest Expense	12,451	28,750			10,125	6,000	22,576	34,750

(a) Copia Technology Services, LLC omitted due to lack of operations since inception in 2002.

**Other, Passive or Venture Capital Investments.**

In addition to its principal business activities focused on the provision of services to small and medium sized business, Newtek also has made investments, usually smaller or in the form of debt, in a number of other companies. For those companies in which Newtek's equity ownership and voting power is less than 25% Newtek is generally not actively involved in the management or day-to-day operations, but offers the businesses advisory services or assistance with particular projects, as well as the collaborative services of its partner companies. In pursuing business objectives, Newtek intends to hold a decreasing portion of its total assets in companies in which it has voting power of less than 25%, but these companies are an important part of the network that Newtek is developing, as they provide access to markets and customer lists that are valuable for all of the other partner companies in one manner or another.

As Newtek pursues its business strategy and focuses on the acquisition of majority or controlling positions in additional partner companies, it expects other company investments to comprise a shrinking portion of its overall income and value. In addition, Newtek may, to the extent possible, increase its interests in these companies so that it has an ownership interest sufficient to integrate them within its network of partner companies. Alternatively, it may dispose of some or all of the interests in other investments if, in the aggregate, they are anticipated to constitute more than 30% of Newtek's non-consolidated total assets (exclusive of Government securities and cash items). See Government Regulation; Investment Company Act of 1940.

A listing of all of the debt or equity investments in these and all other companies is set forth in the Notes to the Consolidated Financial Statements. The principal investments in this category are described below. Note that each of these companies had received significant debt investments from Newtek's capcos (other than MDS) and all have been repaid in full.

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**Distribution Video and Audio, LLC** is a seller of closeout VHS videotapes, DVDs, video games and CD/cassette music units in the wholesale and library markets. This company has built a large inventory of these media products by purchasing on a liquidated basis from major studios and retailers, and distributes these products to other distributors, public libraries, school districts, US Embassies in 120 countries and other traditional means of distribution.

**1-800 Gift Certificate, Inc.** ( 1-800 ) sells corporate incentive programs through proprietary Internet-based programs that are designed to influence consumer and employee behavior by enabling them to select the award of their choice. In conjunction with providing such programs, 1-800 builds a data base of incentive program participants. By retaining the rights to this data base, the company creates powerful revenue opportunities by developing these data bases for third parties. 1-800 combines Internet-based solutions with gift certificates from over 150 national retailers to create dynamic reward/incentive programs. The company's web-based infrastructure provides participants real-time access through multiple channels, both online and off. It also provides administrators with a platform that is flexible, scalable and cost-effective.

**Direct Creations, LLC** is a direct response marketing company that develops and markets products for sale to consumers through short and long-term television advertisement programs, electronic and traditional retail distribution channels and the Internet. The Company launched its first commercial product, the Zen Oracle golf putter in 2001,. The management of the company has many years of experience in the direct response industry, with expertise in the areas of manufacturing, marketing, info-mercial production, advertising and intellectual property development.

**Merchant Data Systems, LLC ( MDS )** (www.merchantdatasystems.com) offers almost all types of businesses an array of services including credit and debit card processing, electronic benefits transfer, electronic check services, equipment sales, leasing and rental programs, 24-7 customer service, supplies and technical support as well as other related payment processing products and services. Through network resources, MDS can offer all the necessary credit card services to meet the needs of almost any commercial establishment in the United States and Canada. MDS relationships include some of the largest FDIC insured banks in the United States.

**BuySeasons, LLC**, a Wisconsin based company, is a retailer of seasonal merchandise and category-specific, informational content on the Internet. The company creates category-specific and uniquely branded web sites that utilize the same personnel and site infrastructure but serve different peak selling periods, thereby leveraging fixed costs and expenses. By producing a family of Internet sites that target specific markets, BuySeasons is able to provide a multitude of products to an increasingly diverse customer base.

### **Investment Selection Philosophy.**

There are currently four prevailing themes in the selection of partner companies which play a guiding if not absolute role in the investments of Newtek, its capcos and subsidiaries.

First, service provider companies that are able to provide business and management services to small and medium sized businesses in a cost effective way. The service

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providers' ability to construct innovative business models, target new market opportunities, define growth plans and develop new service offerings plays an important role in the overall success of Newtek's partner companies as well as other small businesses.

Second, are small businesses that have developed a product or service, sold this product or service to an existing, defined customer base and have successfully captured a meaningful segment of a market. These companies benefit from the other, service provider partner companies' core competencies which are used to support and supplement the existing management skills. This structure lets the management teams exploit their personal strengths as managers and supplement their needs through an integrated network of service provider companies.

Third, are strong management team members and core competencies to add to the partner company network. Generally, these partner company investments involve the replication of an existing partner company's products and services in another geographic region in which Newtek operates.

Fourth, the ability of the business to add large numbers of other small businesses to the marketing universe of affiliated companies as to facilitate the cross marketing of many other products and services. This ties in directly with Newtek's overall objective of aggregating numerous small business markets for purposes of cross marketing.

The Company has adopted a committee approach to investment or partner selection decisions, thereby tapping the experience of all participants in the process. A key feature of Newtek's decision-making process is its requirement that the selection of companies to include within its collaborative network and other investments be made unanimously by the senior management and the local participants in the involved Regional Business Development Center. The Company believes that this unanimity requirement ensures that its decisions will continue to be well developed, sound and consensus oriented.

## **Execution**

**Regional Business Development Centers.** A key to the implementation of Newtek's strategy is its emphasis on its eight Regional Business Development Centers. These offices are staffed or associated with individuals with experience in working with small businesses who are able to identify and evaluate potential partner companies and particularly the local entrepreneurs that Newtek will work with. They are also able to provide important services for Newtek in its monitoring efforts and assist in the promotion and development of the Newtek brands of small business products and services. In many cases, these individuals have made substantial investments in the equity of the capcos associated with their regional centers and retain responsibility for local coordination of communications and compliance with local capco programs.

Once a company becomes associated with Newtek, it benefits not only from access to financing that Newtek can make available or assist in finding, but also from the involvement of Newtek's senior management and its Advisory Committee, (described below), all of whom have significant experience in meeting the critical needs of small businesses.

**Regional Managers.** Newtek's regional management consists of the following individuals.

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**Christopher Bauer, Wisconsin** - Mr. Bauer has had over 28 years of experience in commercial banking at Firststar Corporation, a \$38 Billion diversified financial services company. For the last 10 years Mr. Bauer has served as the President of Firststar Bank of Milwaukee. Firststar Bank of Milwaukee is considered one of the region's leading banks in structuring and financing a host of commercial products, including capital markets, structured finance, mergers and acquisitions and venture equity investments, especially in small to mid-ranged companies. Prior to serving as President, Mr. Bauer directed all merger and acquisition activity for Firststar, following 15 years experience in various capacities focused on consumer and small business banking. He was also a director of the \$10 Million Wisconsin Venture Capital Fund, which assisted small early-stage Wisconsin companies.

**Charles W. Kearns, Wisconsin** - Mr. Kearns has spent the last 16 years working with both regional and national investment banking firm including E.F. Hutton, Salomon Smith Barney, Cleary Gull, and B.C. Ziegler & Co. Mr. Kearns' experience includes Manager of the Financial Institutions and Fixed Income Departments, as well as serving on the Board of Directors at Cleary Gull. Mr. Kearns is currently founder and Principal of Premier Financial Corporation, a financial advisory firm. He has participated in raising venture capital for several enterprises, including Internet and financial service companies, as well as numerous private and public placements of debt and equity securities. Mr. Kearns is also co-founder and owner of Klein Corporation, a manufacturing company in the standby power industry.

**Gregory L. Zink, Florida** - Mr. Zink has over 20 years of broad based international financial and managerial experience in public and private corporations. Mr. Zink also has over 10 years experience in the venture capital business including investing, structuring, consulting, and managing investments in both early stage and mature private and public businesses. Mr. Zink has previously served as the investment advisor and consultant to a private investment trust with assets in excess of \$30 Million as well as a Director, President, CEO and CFO of Heuristic Development Group, Inc. ( HDG ). Mr. Zink was a founder and President at the time of HDG's initial public offering on NASDAQ. He has also been the Chairman and CFO of Nekton Diving Cruises, Inc. and currently serves as a Director, CEO and CFO of Nautilus Group Japan, Ltd. ( NGY). NGJ is the exclusive distributor and franchiser of Nautilus in Japan. During Mr. Zink's tenure, he has negotiated several contracts and a leveraged buyout with some of Japan's largest corporations, including Mitsubishi and Sumitomo. Mr. Zink earned his MBA from the Wharton Business School at the University of Pennsylvania in 1983 and his BS in Finance from Pennsylvania State University in 1979. In 1981, he graduated from General Electric Corporation's Financial Management Program after holding a variety of financial positions at GE's Lighting Business Group in Cleveland, Ohio. Following graduate business school, Mr. Zink was employed as a Senior Consultant with Touche Ross (now merged as Deloitte Consulting). During his three years, he worked on a variety of financial, strategic and operational consulting assignments.

**Jeff M. Schottenstein, Florida** - During the past 30 years, Mr. Schottenstein has been a Director of Schottenstein Investment, a diversified investment holding company with \$650 Million in assets, Vice President of Schottenstein Stores' Value City Stores Division (NYSE symbol VCD) and CEO of Schottenstein Realty Company, which specializes in the investment and restructuring of companies. Mr. Schottenstein has been involved in the capitalization and restructuring of numerous retail enterprises, including Weiboldts' Department Stores, Chicago, Illinois; Strauss Auto Parts, New York, New York; Valley Fair Discount Stores, New Jersey; Steinbach Stores and others. Along with his investors, Jeff Schottenstein has successfully



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acquired Bell Supply Company (retail oil and gas equipment supply company based in Kilgore, Texas) and Omni Exploration Company, the first successful Chapter 11 reorganization of an oil and gas service company in the United States. Mr. Schottenstein also serves on the Board of Directors of Newtek.

**F. Anderson Stone, Louisiana** - Mr. Stone has more than 25 years of institutional credit analysis and investment experience managing high-grade public and private corporate, high yield public corporate, and mortgage-backed fixed income; equity; limited partnership and alternative asset portfolios for income and growth. Mr. Stone has held various life insurance investment positions including Vice President Corporate Securities at Pan-American Life Insurance Company, and Senior Portfolio Manager at The Life Insurance Company of Virginia and Second-Vice President-Investments at Shenandoah Life Insurance Company. As a registered investment advisor and register representative, he has advised individuals and institutions in the formation and implementation of portfolio strategies.

**Dirk E. Sonneborn, New York** - Mr. Sonneborn organized and continues, following Newtek's acquisition, managing and operating the Exponential capco. Mr. Sonneborn has 25 years experience as a certified public accountant and, while at a predecessor firm of PricewaterhouseCoopers, LLP, he was a manager in the Emerging Business Service Group focused on new and emerging businesses. He has managed the capco program and its investments for Exponential and has participated as an investor in numerous technology oriented business ventures in the upstate New York area. He was also a founding member in 1986 of the Technology Business Advisory Group, a trade organization based in Syracuse. As a resource within Newtek's network of companies, Mr. Sonneborn will be available to assist other partner companies their business plans.

**Doug Baird, Colorado** - Mr. Baird is Vice President - Marketing for The Stone Pine Companies, Denver, CO. Since 1997 Mr. Baird has identified Colorado-based venture capital investments for Stone Pine and maintains strong relationships within the state's venture community. He has built and maintains Stone Pine's data base of active private equity funds, sponsors and private equity advisors. Mr. Baird has developed long-standing relationships with senior members of Hamilton Lane Advisors, Inc., the private equity advisor to several large public employee pension systems. For 17 years prior to joining Stone Pine Mr. Baird had developed and/or marketed financial and investment products to institutional and retail clients including leasing portfolios, commercial real estate, public securities and private equity venture transactions. With associates and partners, he has been responsible for raising capital in excess of \$100 Million. In 1991 Mr. Baird founded and served as Managing Director of Golden State Financial Services, LLC, a Denver-based private investment banking firm. Mr. Baird negotiated several private financing facilities including one between a large Denver homebuilder & site developer and GE Capital. Mr. Baird was Vice President and Regional Marketing Director for Franchise Finance Corporation of America (FFCA) from 1988 through 1991. While at FFCA Mr. Baird assisted in raising over \$200 Million in private equity investments for issuers in a variety of industry sectors. Mr. Baird received N.A.S.D. Series 7 and 63 licenses in 1980 and in 1983 began employment with PaineWebber, Inc.

The individuals managing the Regional Business Development Centers (the regional managers) have all participated in the capitalization and organization of the capco located in their area. They serve a number of functions within Newtek's business model. The regional management are the local principals that satisfy any applicable capco requirements for the participation of local parties with investment experience. In addition, each individual, excluding

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Mr. Schottenstein, has consulting agreements with one of Newtek's non-capco subsidiaries whereby they provide time and resources (office space, telephones, supplies, clerical assistance) to the management of their respective capco. Fees paid to the regional managers are a portion of the management fee earned by Newtek for the management of the capco funds, and range in amount from \$77,000 to \$115,000 per year. Two of the individuals devote a much greater proportion of their time to the affairs of the respective capco and are employed by Newtek's subsidiary at salaries of approximately \$120,000 per year. These costs are not paid or reimbursed by the capcos or the partner companies.

These consulting agreements require that the regional managers provide a meaningful amount of their time, but none are on a full time basis and all conduct other activities, and other investments, as well. Included within the services provided are the services provided by Newtek to the investee companies which receive funds from a capco. As the regional managers have been chosen because they have many years of relevant experience, the investee and partner companies are able to benefit from the availability of their experiences, knowledge, contacts, resources and skills. Partner companies and other investees who receive these services do not generally pay anything for them as they are provided by Newtek to ensure the success of its acquisitions and investments. However, when a partner company within Newtek's network purchases services from another partner company, it pays the fair value for those services but because of inter-company elimination, the effect on Newtek is nil.

Similarly, the capcos themselves require attention for the identification of debt or equity investments in order to meet their respective minimum investment goals under the programs. The regional managers are an important part of Newtek's efforts to identify and screen appropriate investments because of their deep knowledge of and participation in their communities. The cost of these services are included in the consulting agreements with the individuals. Finally, because of their stature in their communities, the regional managers are able to assist Newtek in its newer initiatives in non-capco areas

Newtek's Regional Business Development Centers are located as follows:

Wisconsin  
1330 West Towne Square Road  
Mequon, Wisconsin 53902

New York  
462 Seventh Avenue, 14<sup>th</sup> Floor  
New York, New York 10018

Florida  
1000 Brickell Avenue  
Miami, Florida 33131

New York  
100 Quentin Roosevelt Blvd.  
Garden City, New York 11550

Florida  
Boynton Beach, Florida

New York  
216 Walton Street  
Syracuse, New York 13202

Louisiana  
1 Canal Place  
New Orleans, Louisiana 70130

Alabama  
250 Commerce Street  
Montgomery, AL 36104

Colorado  
1530 16<sup>th</sup> Street  
Denver, Colorado 80202

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**Advisory Committee.** The Advisory Committee has been used as a direct extension of Newtek management. Advisory Committee members are a source of information and are used to focus on specific technologies and industries where the highest level of sophistication is required for business development. The Advisory Committee consists of individuals from diverse backgrounds, but with specific knowledge regarding different aspects of business development and technology. The individuals include:

Michael Balboni - New York State Senator

Barry Simon - Vice President, Content Development - American Express

Thomas P. Falus - President, Strategic Ventures Group, and Director, Cushman & Wakefield, Inc.

Members of the Newtek Advisory Committee have provided or are currently providing assistance in areas such as the introduction and negotiation of potential joint ventures, marketing analysis and strategic advice to Newtek and the partner companies and management recruitment assistance. Specifically, advisory members have provided assistance to partner companies in the area of negotiating a consumer credit facility with a major national financial service provider and have assisted in the solicitation of credit card processing businesses. The members of Newtek's Advisory Committee have made themselves available to consult with management or partner companies on an as needed basis. The compensation provided to the members of the Advisory Committee has been in the form of, generally 10,000, stock options. Depending on the scope and extent of services provided by a member of the Advisory Committee, Newtek may agree to enter into additional compensation arrangements if so warranted. Newtek is not currently under contract to any of the Advisory Committee members and is under no obligation to make any future payments to any of them.

## **Government Regulation; Investment Company Act of 1940**

**Overview.** Because of the nature of the business of Newtek, management of Newtek has addressed the question of the application of the Investment Company Act of 1940, as amended (the Investment Company Act), to the business of Newtek. As discussed below, the application of the Investment Company Act to Newtek would impose requirements and limitations that are materially inconsistent with Newtek's current and intended business strategy. However, with the increase during 2001 and 2002 of investment focus on operating companies, management believes that concern for unintended holding company status has been decreased materially.

Companies that are publicly offered in the U.S. and which (1) are, or hold themselves out as being, engaged primarily or proposing to engage primarily in the business of investing, reinvesting or trading in securities, or (2) own or hold investment securities exceeding 40% of the value of their total assets (adjusted to exclude U.S. government securities and cash) and are engaged in the business of investing, reinvesting, owning, holding or trading in securities, are considered to be investment companies under the Investment Company Act. Unless an exclusion from registration were available or obtained by grant of a Securities and Exchange Commission (SEC) order, these companies must register under this Act and, thus, become subject to extensive regulation regarding several aspects of their operations.

The SEC has adopted Rule 3a-1 that provides an exclusion from registration as an investment company if a company meets both an asset and an income test and is not otherwise primarily engaged in an investment company business by, among other things, holding itself out

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to the public as such or by taking controlling interests in companies with a view to realizing profits through subsequent sales of these interests. A company satisfies the asset test of Rule 3a-1 if it has no more than 45% of the value of its total assets (adjusted to exclude U.S. government securities and cash) in the form of securities other than interests in majority owned subsidiaries and companies which it primarily and actively controls. A company satisfies the income test of Rule 3a-1 if it has derived no more than 45% of its net income for its last four fiscal quarters combined from securities other than interests in majority owned subsidiaries and primarily and actively controlled companies.

Newtek's business strategy and business activities involve taking mainly majority-ownership and primary controlling interests in partner companies with a view to participating actively in their management and development. Newtek believes that this strategy and the scope of its business activities would not cause it to fall within the definition of investment company or, if so, provide it with a basis for an exclusion from the definition of investment company under the Investment Company Act.

**Consequences of Investment Company Regulation.** Investment Company Act regulations are inconsistent with Newtek's strategy of actively managing, operating and promoting collaboration among its network of partner companies, and it is not feasible for Newtek to operate its business as a registered investment company. Newtek believes that because of the planned structure of Newtek's interests in its partner companies and its business strategy, it will not be regulated under the Investment Company Act. However, Newtek cannot assure you that the structure of its partner company interests and other investments and its business strategy will preclude regulation under the Investment Company Act, and Newtek may need to take specific actions that would not otherwise be in its best interests to avoid such regulation.

If Newtek falls under the definition of an investment company, and is unable to rely on an available exclusion or to obtain an order of the SEC granting an exclusion, it would have to register under the Investment Company Act and comply with substantive requirements under the Investment Company Act applicable to registered investment companies. These requirements include:

limitations on Newtek's ability to borrow;

limitations on Newtek's capital structure;

restrictions on acquisitions of interests in associated companies;

prohibitions on transactions with affiliates;

restrictions on specific investments; and

compliance with reporting, record keeping, voting, proxy disclosure and other rules and regulations.

These rules and regulations would significantly change Newtek's operations and prevent it from executing its business model.

**Government Regulation; State Capco Regulations**

Each of the states which operate capco tax credit programs have established administrative mechanisms to monitor compliance with the requirements of the programs, that is to verify that the capcos have met applicable minimum investment requirements and are otherwise acting in conformance with the statutes and rules. Requirements include limitations on the initial size of the recipients of the capco funds, including the number of their employees, the location within the respective state of the recipients and the recipients' commitment to remain therein for a specified period of time, the types of business conducted by the recipients, and the

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terms of the investments in the recipients. Capcos are required to maintain detailed records so as to demonstrate to state examiners compliance with all applicable requirements. Contrary to other programs, the regulatory requirements applicable to capcos are, generally, limited to the minimum investment requirements. The capcos operated by Newtek are currently in full compliance with all applicable requirements and management anticipates no difficulty in maintaining that status in the future.

### **Government Regulation: Sarbanes-Oxley Act of 2002**

On July 30, 2002, the President of the United States signed the Sarbanes-Oxley Act of 2002 into law. The Sarbanes-Oxley Act provides for sweeping changes with respect to corporate governance, accounting policies and disclosure requirements for public companies, and also for their directors and officers. Section 302 of the Sarbanes-Oxley Act ( Corporate Responsibility for Financial Reports ) required the SEC to adopt new rules to implement the requirements of the Sarbanes-Oxley Act. These requirements include new financial reporting requirements and rules concerning corporate governance. New SEC rules, effective August 29, 2002, require a reporting company's chief executive and chief financial officers to certify certain financial and other information included in the company's quarterly and annual reports. The rules also require these officers to certify that they are responsible for establishing, maintaining and regularly evaluating the effectiveness of the company's disclosure controls and procedures; that they have made certain disclosures to the auditors and to the audit committee of the board of directors about the company's controls and procedures; and that they have included information in their quarterly and annual filings about their evaluation and whether there have been significant changes to the controls and procedures or other factors which would significantly impact these controls subsequent to their evaluation.

See Certifications for certifications by Newtek's Chief Executive Officer and Chief Financial Officer of the financial statements and other information included in this Annual Report on Form 10-KSB. See Item 14 ( Controls and Procedures ) below for Newtek's evaluation of disclosure controls and procedures. The certifications required by Section 906 of the Sarbanes-Oxley Act also accompany this Form 10-KSB.

### **Shareholder Value**

Throughout its existence since 1998, Newtek's principal business objective has been to promote longer-term shareholder value for its shareholders and those of its partner companies. However, because of the way in which the business has been focused beginning in 2001 and primarily in 2002, the manner in which this value may be achieved has changed.

From 1998 through 2001, management expected that material shareholder value ultimately would be realized through the growth of each individual partner company leading to independent creation of value, possibly in the form of a public offering of the stock of the partner companies. In the event of such a public offering by a partner company, Newtek would generally expect to retain a majority or controlling interest in such a partner company and to benefit as a shareholder from the increased public company value. Other possible liquidity events could be the merger or sale of an entire company.

Primary emphasis is now being placed by management on assisting the Newtek partner companies to develop as successful businesses, with earnings, surplus cash flow and the aggregation of other small business customers. The NEWTEK branding strategy will help in consolidating the group of related small business services. Because of this approach, the

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likelihood of a sale or public offering of one of the partner companies is smaller now due to the expectation of greater benefit to be gained by keeping all as part of the whole. However, notwithstanding these objectives, Newtek may from time to time undertake sales of its interests in partner companies when it believes the action to be in Newtek's and the shareholders' overall best interests. Such possible sales could be influenced in part by the need to monitor and control the receipt of the type of income that would cause Newtek to be subject to regulation as an investment company. See Government Regulation: Investment Company Act of 1940 - Asset and Income Composition.

### **Risks Associated with Newtek's Business**

The following factors are important to understand management's current assessment of the principal risks associated with Newtek's business.

1. There is a risk that Newtek and its partner companies may not be profitable on a consolidated basis, or may never become profitable. Newtek's partner companies are now and are expected to remain in early stages of development and will have limited revenues. Further, the income, if any, generated by partner companies will be offset by losses of other partner companies. Moreover, Newtek's continuing acquisition of interests in early stage partner companies may further hinder profitability. Newtek's short-term success will depend heavily on the continued operations of its capcos which in 2002 produced 88% of revenues and were the principal reason Newtek generated net income in 2002 and 2001.

2. The value of Newtek's common stock would be materially impacted by the performance of the companies in which it invests, aspects of which may be outside the control of Newtek. Each of the companies and their businesses may be effected by economic, governmental, industrial and internal factors outside the control of Newtek. If the companies do not succeed and generate income, the value of Newtek's assets and the price of Newtek's stock would decline.

3. Because Newtek's capcos are subject to various state law requirements, a failure of any of them to meet these requirements could subject the capco and Newtek's shareholders to serious financial consequences. In general, Newtek's capcos issue debt instruments to insurance company investors and the capcos then acquire interests in companies in accordance with applicable state statutes. In return, the states issue tax credits to the capcos, which are available to and used by the insurance company investors to reduce their state tax liabilities. In order to maintain its status as a capco and to avoid the recapture of the tax credits granted, each capco must meet a number of state requirements. A key requirement in order to continue capco certification is that a capco must comply with minimum investment schedules that benchmark both the timing and type of required investments. A final loss of capco status, that is decertification as a capco, results in loss of the tax credits.

Because each of Newtek's capcos utilizes a substantial portion of its initial funding to pay for credit enhancement and capco insurance, its cash available for investment to meet these minimum investment requirements is reduced. Losses by the capcos on their investments would make it significantly more difficult for the capcos to meet minimum state statutory investment benchmarks. In all capco programs, the risk of decertification is not eliminated until the capco meets a minimum 50% investment threshold.

4. Under the terms of insurance purchased by the capcos for the benefit of the investors, the capco insurer would be authorized, in the event of a threat of decertification by a state, to assume up to complete control of a capco so as to avoid final decertification and interest

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payments. While avoiding final decertification, control by the insurer would result in significant disruption of the capco's business and likely result in financial loss to the capco and possibly Newtek and its shareholders.

5. A substantial portion of Newtek's 2002 and 2001 revenue was derived from the recognition of income related to tax credits available under current certified capital company programs in which it participates. Newtek will recognize additional income over the next four to ten years from these programs. Thereafter, unless additional capco programs are adopted and Newtek is able to participate in them Newtek will derive no new revenue from this source. The adoption of new state capco programs in the future could be materially and adversely affected by the continuation of current adverse economic conditions. If adverse conditions continue, the willingness of state governments to provide capco tax credits could be materially diminished. In the absence of income from this source, Newtek would have only the income it derives from its current and future investments.

6. Because Newtek's method of recognition of income derived from the capco tax credits causes most or all such income to be recognized in early years of the programs, in the absence of income from other sources, Newtek and its capcos could sustain material losses in later years. Despite the cessation of tax credit income, Newtek will continue to incur costs for the administration of the capcos.

## **Employees**

As of December 31, 2001, Newtek and the companies in which it holds a controlling interest had approximately 160 employees, independent representatives and contract employees, of which 11 assist on an as-needed basis with the operation of capcos in Florida, Wisconsin and Louisiana. Newtek believes its labor relations are good and none of its employees are covered by a collective bargaining agreement.

## **Item 2. DESCRIPTION OF PROPERTY**

Newtek maintains leased office space at 462 Seventh Avenue, 14th Floor, New York, New York, 10018 and leases an additional office at 100 Quentin Roosevelt Blvd, Garden City, New York. As of December 31, 2002, Newtek also leased offices for the capcos and other subsidiaries in the following locations:

Syracuse, New York

New Orleans, Louisiana

Miami, Florida

Boynton Beach, Florida

Milwaukee, Wisconsin; and,

Denver, Colorado

Newtek leases office space for its Manhattan office at an annual cost of approximately \$240,000 on a lease which expires in 2011, or approximately \$25 per square foot. Space of the Garden City office is leased on a lease which expires in 2005 at an annual cost of \$73,000, or approximately \$21 per square foot. All other office leases are on a month-to-month basis. Newtek believes that its office space is satisfactory for its current needs.

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As a result of the acquisition of REXX on September 19, 2000, Newtek acquired title to a warehouse previously used by REXX in a former business. In March, 2002, the property was sold for a gain of \$16,841 over its previously written-down book value as of December 31, 2001. Newtek received payment in cash and applied the proceeds to pay off the outstanding mortgage.

**Item 3. LEGAL PROCEEDINGS**

From time to time, Newtek and its subsidiaries are parties to various legal proceedings incident to its business. At December 31, 2002, there were no legal proceedings which management anticipates would have a material adverse effect on Newtek.

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

During the quarter ended December 31, 2001 Newtek held a special meeting of stockholders on November 5, 2002, at which time the change of the company's name from that of Newtek Capital, Inc., to that of Newtek Business Services, Inc. was approved as was the change of the company's official address for the service of process. At the meeting on November 5, 2002, there were present in person or by proxy shares representing 62.6% of the total outstanding shares at that date of 24,698,542. The amendment to the company's Certificate of Incorporation was approved for the change of name by a vote of 15,637,175 for and 250 against; and for the change of address by a vote of 15,635,175 for and 2,250 against.

**PART II****Item 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS**

**(a) Market Information.** The following table sets forth, for the periods indicated, the range of high and low closing sale prices for Newtek's common stock on the American Stock Exchange ( AMEX ). Newtek's common stock trades under the symbol NKC . The stock began trading on the AMEX on September 20, 2000.

	Closing Price	
	High	Low
First Quarter (January 1, 2002 through March 31, 2002)	\$ 3.95	\$ 3.00
Second Quarter (April 1, 2002 through June 30, 2002)	\$ 5.20	\$ 3.20
Third Quarter (July 1, 2002 through September 30, 2002)	\$ 4.24	\$ 3.15
Fourth Quarter (October 1, 2002 through December 31, 2002)	\$ 4.39	\$ 3.20
First Quarter (January 1, 2003 through March 17, 2003)	\$ 5.30	\$ 3.80

**Sales of Unregistered Securities:** During the fourth calendar quarter of 2002, Newtek sold the following common stock or options for common stock of the company in unregistered, private placement, transactions.

DATE	PURCHASER	SHARES	PRICE
Sept 30, 2002	Gregory Zink	Options for 40,302	(1)
Sept 30, 2002	Jeffrey M. Schottenstein	Options for 211,753	(1)
Oct. 15, 2002	7 major insurance companies	46,200	\$ 3.55 (2)
Dec. 10, 2002	Daniel Breen	25,000	\$ 3.00
Dec. 16, 2002	North American Ins., Co.	19,223	(3)
Dec. 16, 2002	Republic Western Ins., Co.	21,359	(3)
Dec. 17, 2002	Celia Holtzberg	11,224	(3)
Dec. 31, 2002	54 holders of Comcap Holdings Corp stock	380,471 + 82,980	\$ 3.38 (4)



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(1) The options sold to Messrs. Schottenstein and Zink were in exchange for their interests in one of Newtek's capcos, Wilshire Partners, LLC. These two individuals are residents of Florida and were participants in the organization and capitalization of the capco and participate as Regional Managers in its operations (see, Business Execution Regional Managers). The options are exercisable for \$0.01 for ten years but may not be exercised fully for the first three years. Due to the restrictions attached to the options and the unregistered underlying securities, the parties negotiated a valuation on the interest exchanged equal to the market price of Newtek's stock at the time (\$3.30), reduced by a 45% discount due to lack of liquidity, times the number of shares. The price paid was, thus, \$73,148 for Mr. Zink and \$384,332 for Mr. Schottenstein. This exchange is a part of Newtek's program to reduce or eliminate minority interests in its subsidiary companies. Mr. Schottenstein was throughout 2002 a director of Newtek but did not take part in the consideration or approval of the foregoing transaction, which was negotiated by management and approved by the remaining members of the board.

(2) In conjunction with the funding of Newtek's most recent capco fund, Wilshire Louisiana Partners III, LLC, Newtek facilitated the marketing of the capco's debt by contributing to the capco the 46,200 shares to be sold to the insurance companies which participate in funding the capco. The shares had a market value on the date of funding of \$3.55 per share. The purchasers were The Equitable Life Assurance Society of the United States (\$37,275), American Memorial Life Insurance Company (\$9,940), Fortis Benefits Insurance Company (\$16,153), First Colony Life Insurance Company (\$31,063), American Home Assurance Company (\$24,850), the Prudential Insurance Company of America (\$34,790) and PRUCO Life Insurance Company (\$9,940).

(3) Non-cash exchanges of either warrants for shares of one of Newtek's capcos or a minority interest in a capco, in furtherance of Newtek's program to reduce minority interests. The shares issued were unregistered and the insurance companies agreed to hold the shares for a period of up to three years and a discount of 45% was applied to the market value on the date of issue of \$3.70. The price paid was thus \$31,119 for North American, \$43,466 for Republic and \$22,840 for Ms. Holtzberg. Ms. Holtzberg is an employee of one of Newtek's partner companies and earned the interest here exchanged by her efforts in the marketing of the capco's notes during 2002.

(4) Stock issued in exchange for the stock of Comcap Holdings Corp. and Commercial Capital Corporation. The valuation of this acquisition is discussed at Note 18 to the Consolidated Financial Statement. Of the total of 463,451 shares, 82,980 are held in escrow pending the achievement of certain hurdles contained in the indemnity agreement for certain possible losses. The market price as of the date of the announcement of the transaction was \$3.38 to which Newtek applied a

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discount of 30% representing the reduced liquidity due to the nature of the unregistered shares issued without registration rights.

**(b) Holders.** On March 17, 2003, as reported by Newtek's transfer agent, shares of common stock were held by approximately 437 people, based on the number of record holders, including nominees for an undetermined number of beneficial owners.

**(c) Dividends.** To date, Newtek has not paid any cash dividends on our common stock. Any determination to pay dividends in the future will be at the discretion of Newtek's Board of Directors. The Board's determination whether to pay dividends in the future will be at the discretion of Newtek's Board of Directors. The Board's determination whether to pay dividends will depend upon Newtek's earnings, if any, financial condition and capital requirements as well as other relevant factors. The Board of Directors does not intend to declare dividends in the foreseeable future, but instead intends to retain earnings, if any, for use in Newtek's business operations.

**(d) Securities Authorized for Issuance Under Equity Compensation Plans.**

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	2,456,837	\$ 4.30	1,793,163
Equity compensation plans not approved by security holders	0	0	0
<b>Total</b>	<b>2,456,837</b>	<b>\$ 4.30</b>	<b>1,793,163</b>

None of these options have been granted to Messrs. Sloane, Rubin or Wasserman.

**Item 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION****Introduction and Certain Cautionary Statements**

*The following discussion and analysis of our financial condition and results of operations focuses on and is intended to clarify the results of our operations, certain changes in our financial position, liquidity, capital structure and business development for the periods covered by the consolidated financial statements included in this Annual Report. This discussion should be read in conjunction with, and is qualified by reference to, the other related information including, but not limited to, the audited consolidated financial statements (including the notes*

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*thereto and the independent auditor's report thereon), the description of our business, all as set forth in this filing, as well as the risk factors discussed below.*

*The discussion set forth below, as well as other portions of this filing, contains statements concerning potential future events. Readers can identify these forward-looking statements by their use of such verbs as expects, anticipates, believes or similar verbs or conjugations of such verbs. If any of our assumptions on which the statements are based prove incorrect or should unanticipated circumstances arise, our actual results could materially differ from those anticipated by such forward-looking statements. The differences could be caused by a number of factors or combination of factors including, but not limited to, those discussed below. Readers are strongly encouraged to consider those factors when evaluating any such forward-looking statement. We will not update any forward-looking statements in this filing.*

## **Critical Accounting Policies**

**Revenue Recognition.** 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 entitled to earn tax credits upon satisfying defined investment percentage thresholds within specified time requirements. Newtek has capcos in five states. Each statute requires that the capco invest a threshold percentage of certified capital (the funds provided by the insurance company investors) in businesses defined as qualified within the time frames specified. As the capco meets these requirements, it avoids grounds under the statute for its disqualification for continued participation in the capco program. Such a disqualification, or decertification as a capco results in a permanent recapture of all or a portion of the allocated tax credits. The proportion of the possible recapture is reduced over time as the capco remains in general compliance with the program rules and meets the progressively increasing investment benchmarks. As the capco progresses in its investments in Qualified Businesses and, accordingly, places an increasing proportion of the tax credits beyond recapture, it earns an amount equal to the non-recapturable tax credits and records such amount as income, with a corresponding asset called credits in lieu of cash in the balance sheet.

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

Interest income on loans is recognized as earned. When a loan is 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, the accrual of interest is discontinued and all accrued but uncollected interest income is reversed. Cash payments subsequently received on nonaccrual loans are recognized as income only where the future collection of the recorded value of the loan is considered by management to be probable. Certain related direct costs to originate

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loans (including fees paid to loan brokers) are deferred and amortized over the contractual life of the loan using a method that approximates the effective interest method.

**Defeasance of Debt.** At the initiation of the transaction, the capco issues notes to the insurance company investors and takes some of the cash proceeds and purchases an insurance contract from American International Specialty Lines Insurance Company, an insurance company subsidiary of The American International Group, Inc.

This transaction makes the insurer the primary obligor for the principal payment at maturity (i.e., the insurer must repay the principal at maturity). As a result, no liability for the recognition of the Principal is recorded on the capco's books. However, the capco remains secondarily liable for such principal payment and must periodically assess the likelihood that it will become primarily liable and, if necessary, record a liability at that time.

**Investment Valuation.** The various interests that the capcos and Newtek acquire as a result of their investments are accounted for under three methods: consolidation, equity method and cost method. The applicable accounting method is generally determined based on Newtek's voting interest in a company, and monthly valuations are performed so as to keep Newtek's records current in reflecting the operations of all of its investments.

Companies in which Newtek directly or indirectly owns more than 50% of the outstanding voting securities or those Newtek has effective control over are generally accounted for under the consolidation method of accounting and are referred to as Newtek's partner companies. Under this method, an investment's results of operations are reflected within Newtek's Consolidated Statement of Operations. All significant intercompany accounts and transactions are eliminated. The results of operations and cash flows of a consolidated partner company are included through the latest interim period in which Newtek owned a greater than 50% direct or indirect voting interest for the entire interim period or otherwise exercised control over the partner company. Upon dilution of control at or below 50%, the accounting method is adjusted to the equity or cost method of accounting, as appropriate, for subsequent periods.

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

Companies not accounted for under the consolidation or the equity method of accounting are accounted for under the cost method of accounting, for which monthly valuations are performed. Under this method, Newtek's share of the earnings or losses of such companies is not included in the Consolidated Statements of Operations, but the investment is carried at historical cost. In addition, cost method impairment charges are recognized as necessary, in the Consolidated Statement of Income if circumstances suggest that this is an other than temporary decline in the value of the investment, particularly due to losses. Subsequent increases in value, if any, of the underlying companies are not reflected in Newtek's financial statements until realized in cash. Newtek records as

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income amounts previously written off only when and if Newtek receives cash in excess of its remaining investment balance.

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

## **New Accounting Pronouncements**

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 addresses financial accounting and reporting for business combinations and is effective for all business combinations after June 30, 2001. SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets and is effective for fiscal years beginning after December 15, 2001. This statement requires that goodwill and intangible assets with indefinite useful lives no longer be amortized but instead tested for impairment at least annually. The Company has determined that no impairment existed as of December 31, 2002. The adoption of these standards did not have a material impact on Newtek's financial position or results of operations.

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, and the accounting and reporting provisions of Accounting Principles Board (APB) Opinion No. 30, Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, for the disposal of a segment of a business (as previously defined). The provisions of SFAS No. 144 are effective for financial statements issued for fiscal years beginning after December 15, 2001, with early application encouraged and generally are to be applied prospectively. The adoption of SFAS No. 144 did not have a material impact on Newtek's financial position or results of operations.

In April 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections (FAS 145). This statement eliminates the requirement that gains and losses from the extinguishment of debt be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. However, an entity would not be prohibited from classifying such gains and losses as extraordinary items so long as they are both unusual in nature and infrequent in occurrence. This provision of FAS 145 will be effective for Newtek as of the beginning of fiscal year 2004. This statement also amends FAS 13, Accounting for Leases, and certain other authoritative pronouncements to make technical corrections or clarifications. FAS 145 will be effective related to the amendment of FAS 13 for all transactions occurring after May 15, 2002. All other provisions of FAS 145 will be effective for financial statements issued after May 15, 2002. Newtek has determined that this Statement will have no significant impact on the company's financial condition and

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results of operations.

In July 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, which addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes EITF No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF No. 94-3, a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. The provisions of SFAS No. 146 will be adopted for exit or disposal activities that are initiated after December 31, 2002. Newtek is currently evaluating the impact of implementing FAS 146.

In October 2002, the FASB issued Statement No. 147 ( SFAS 147), *Acquisitions of Certain Financial Institutions*. SFAS 147 addresses financial accounting and reporting for the acquisition of all or part of a financial institution, except for a transaction between two or more mutual enterprises. SFAS 147 also provides guidance on the accounting for the impairment or disposal of acquired long-term customer-relationship intangible assets of financial institutions, including those acquired in transactions between two or more mutual enterprises. The provisions of the statement will be effective for acquisitions on or after October 1, 2002. The adoption of SFAS No. 147 is not expected to have a material impact on Newtek's financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* an amendment of SFAS No. 123. This Statement amends SFAS No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The adoption of SFAS No. 148 did not have a material impact on Newtek's financial position or results of operations.

In November 2002, the FASB issued FASB Interpretation ( FIN ) No. 45, *Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees and Indebtedness of Others*, an interpretation of FIN No. 5, 57 and 107, and rescission of FIN No. 34, *Disclosure of Indirect Guarantees of Indebtedness of Others*. FIN 45 elaborates on the disclosures to be made by the guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002; while, the provisions of the disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. In the normal course of business, the Company enters into contracts that contain a variety of representations and warranties and provide general indemnifications. The Company's maximum exposure under these arrangements is unknown, as this would involve future claims that may be made against the Company that have not yet occurred. Based on the Company's experience, the Company expects the risk of loss to be remote.

In January 2003, the FASB issued FIN No. 46, *Consolidation of Variable Interest Entities*, an interpretation of Accounting Research Bulletin No. 51. FIN No. 46 requires that

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variable interest entities be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or is entitled to receive a majority of the entity's residual returns or both. FIN No. 46 also requires disclosures about variable interest entities that companies are not required to consolidate but in which a company has a significant variable interest. The consolidation requirements of FIN No. 46 will apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements will apply to entities established prior to January 31, 2003 in the first fiscal year or interim period beginning after June 15, 2003. The disclosure requirements will apply in all financial statements issued after January 31, 2003. Newtek is currently evaluating the impact of implementing FIN No. 46.

**Comparison of the years ended December 31, 2002 and December 31, 2001**

Revenues increased by approximately \$10,824,000 to \$34,624,000 for the year ended December 31, 2002, from \$23,800,000 for the year ended December 31, 2001. Income from tax credits increased by approximately \$9,105,000, from \$21,498,000 for the year ended December 31, 2001, to \$30,603,000 for the year ended December 31, 2002, due to Newtek's capcos achieving various additional investment thresholds mandated by the various state capco statutes in 2002 versus 2001. Interest and dividend income decreased by approximately \$945,000 to \$900,000 for the year ended December 31, 2002, from \$1,845,000 for the year ended December 31, 2001. This decrease was due primarily to lower bank interest rates and less loans outstanding to qualified businesses. Consulting fee income increased by approximately \$379,000 to \$388,000 for the year ended December 31, 2002, from \$9,000 for the year ended December 31, 2001, due to one of Newtek's partner companies experiencing a significant increase in consulting income. Other income increased by approximately \$2,285,000 to \$2,733,000 for the year ended December 31, 2002 from \$448,000 for the year ended December 31, 2001. This increase was due to the consolidation of revenues with additional partner companies (mostly credit card processing entities) now consolidated into Newtek.

Interest expense decreased by approximately \$92,000 to \$11,485,000 for the year ended December 31, 2002 from \$11,577,000 for the year ended December 31, 2001. The decrease was due primarily to the reduction of interest payable due to delivery of tax credits to certified investors. Payroll and consulting fees increased by approximately \$1,901,000 to \$4,566,000 for the year ended December 31, 2002 from \$2,665,000 for the year ended December 31, 2001. The increase was due to the consolidation of operating expenses with additional partner companies now consolidated into Newtek. Professional fees increased by approximately \$1,084,000 to \$3,145,000 for the year ended December 31, 2002 from \$2,061,000 for the year ended December 31, 2001. This increase is due to the new capco and capco fund that were formed in the year. Insurance expense increased by approximately \$421,000 to \$1,951,000 for the year ended December 31, 2002 from \$1,530,000 for the year ended December 31, 2001. This increase is due to the new prepaid insurance amortization on the newly formed capco and capco fund that were formed in the year.

Other expenses increased by approximately \$2,497,000 to \$3,672,000 for the year ended December 31, 2002 from \$1,175,000 for the year ended December 31, 2001. The increase was due primarily to the consolidation of operating expenses from additional partner companies now consolidated into Newtek.

Newtek determined that there was \$1,574,000 of other than temporary decline in the value of some of its investments (net of recoveries), versus \$372,000 for the same period last

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year. The increase was due primarily to management's analysis of its investments which indicated more impairment for the current period. Newtek considers several factors in determining whether an impairment exists on the investment, such as the investee's net book value, cash flow, revenue and net income. Newtek recognizes that in developing new and small businesses, significant impairments in the value of the investments may occur.

Net income increased by approximately \$7,238,000, to net income of \$8,168,000 for the year ended December 31, 2002, compared to net income of \$930,000 for the year ended December 31, 2001, due to the increases in revenue and general and administrative expenses discussed above, offset by the increase in other than temporary decline in investments of approximately \$1,202,000, decreased equity in losses of approximately \$1,551,000 due to the consolidation of certain investments previously accounted for under the equity method, an increase in income taxes of approximately \$2,122,000, and the extraordinary gains of \$3,643,000 (of which \$2,735,000 is attributable to Newtek's acquisition of Commercial Capital, and \$908,000 to Newtek's acquisition of minority interests.)

**Partner Companies:** At December 31, 2002, Newtek had fourteen majority-owned partner companies, all of which were as a result of investments through the capco programs. For the year ended December 31, 2002, these companies represented approximately \$3,416,000 in losses that are consolidated in Newtek's results. For the year ended December 31, 2001, these companies represented approximately \$904,000 in losses that are consolidated in Newtek's results.

At December 31, 2002, Newtek had four companies accounted for under the equity method, all of which were as a result of investments through the capco programs. For the year ended December 31, 2002, these companies represented approximately \$729,000 in losses that are shown on the consolidated statement of income as equity in net losses of affiliates. For the year ended December 31, 2001, these companies represented approximately \$2,280,000 in losses that are shown on the consolidated statement of income as equity in net losses of affiliates.

## **Liquidity and Capital Resources**

Newtek has funded its operations primarily through the issuance of notes to insurance companies through the capco programs. Through December 31, 2002, Newtek has received approximately \$166,700,000 in proceeds from the issuance of long-term debt, Capco warrants, and Newtek common stock through the capco programs. Newtek's principal capital requirements have been to fund the defeasance of the principal amount of notes issued to the insurance companies (approximately \$94,081,000), the acquisition of capco insurance policies (\$18,519,000), the acquisition of partner companies interests, finding of other capco-qualified investments, and working capital needs resulting from operating and business development activities of its partner companies.

Net cash used in operating activities for the twelve months ended December 31, 2002 of approximately \$9,908,000 resulted primarily from net income of \$8,168,000 adjusted for the non-cash interest expense of approximately \$10,733,000 and non-cash income tax expense of approximately \$2,657,000. It was also affected by the approximately \$729,000 in equity in net losses of affiliates and approximately \$335,000 of minority interest. This was offset by the approximately \$30,603,000 in non-cash income from tax credits and \$3,643,000 in extraordinary



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gains. In addition, Newtek had an increase in components of working capital of approximately \$118,000.

Net cash provided by investing activities for the year ended December 31, 2002 of approximately \$9,266,000 resulted primarily from approximately \$16,196,000 in additional qualified investments made in the period offset by repayments on debt instruments of \$8,743,000, cash from consolidation of entities of \$14,173,000 and the \$2,475,000 in cash received in connection with the acquisitions of Exponential and Commercial Capital.

Net cash provided by financing activities for the year ended December 31, 2002 was approximately \$10,642,000 primarily attributable to the approximately \$30,000,000 in proceeds from the issuance of long term debt, net proceeds of approximately \$720,000 from the issuance of common stock to certified investors, and net proceeds of approximately \$1,371,000 from the net proceeds from issuance of stock during the twelve months ended December 31, 2002. This was offset by payments on a premium financing note payable-insurance of approximately \$7,034,000, debt defeasance of approximately \$14,514,000 and the full repayment of a mortgage obligation of approximately \$307,000.

**Liquidity Risk.** Newtek believes that its cash and cash equivalents, its anticipated cash flow from operations, its ability to access private and public debt and equity markets, and the availability of funds under its existing JP Morgan line of credit will provide it with sufficient liquidity to meet its short and long-term capital needs. The loss of any one or two of these liquidity sources would not present an impossible obstacle to Newtek's operations. However, the failure of the insurer, which is primarily liable for the repayment of the capco defeased debt of \$149,337,000 would require the capcos to assume this repayment obligation upon the maturity of the notes. Management has determined that the likelihood of the capcos becoming primarily liable for a material portion of this debt due to the failure of the insurer, which is a subsidiary of The American International Group, Inc., and is currently credit rated as AAA, is remote.

The following chart represents Newtek's obligations and commitments, as of December 31, 2002, other than capco debt repayment discussed above for future cash payments under debt, lease and employment agreements:

Year	Debt	Leases	Employment Agreements	Total
2003	\$ 3,860,588	\$ 752,149	\$ 855,000	\$ 5,467,737
2004	2,197,013	735,503	855,000	3,787,516
2005	1,184,567	374,769	855,000	2,414,336
2006		345,534		345,534
2007		258,867		258,867
2008+	3,810,161	1,562,121		5,372,282
<b>Total</b>	<b>\$ 11,052,329</b>	<b>\$ 4,028,943</b>	<b>\$ 2,565,000</b>	<b>\$ 17,646,272</b>

This chart excludes the taxes due to capco minority owners (which can not be anticipated).

Commercial Capital Corp. ( CCC ), at the time of its acquisition by the Company had a \$10 Million line of credit with a bank. As of December 31, 2002, the amounts outstanding under this line of credit were \$3,998,630 and were assumed by Newtek in connection with its acquisition of CCC (included in Bank Notes Payable on the accompanying consolidated balance sheet). The line of credit is collateralized by loans made by CCC. The line of credit bears interest at the prime interest rate plus 1% with interest payable monthly. The average rate for the year ended December 31, 2002 was 5.76%. The rate at December 31, 2002 was 5.25%. There was no accrued interest payable under this line of credit as of December 31, 2002. In addition, this line of credit requires that a percentage of all advances made to CCC be deposited into an

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account in the name of the bank. The balance in this account as of December 31, 2002 was \$198,467 and is included in receivable from bank on the accompanying consolidated balance sheet.

CCC also had a line of credit with another bank for \$75,000,000. As of December 31, 2002, the amount outstanding under this line of credit was \$51,325,862 and, less \$1,500,000 which was converted into CCC Preferred Stock, was assumed by Newtek in connection with its acquisition of CCC (included in Bank Notes Payable on the accompanying consolidated balance sheet). The line of credit bears interest at the one-month LIBOR rate plus 2.50%, and was collateralized by the loans made by CCC. The average interest rate for the year ended December 31, 2002 was 4.3%. The interest rate at December 31, 2002 was 3.88%. Interest on the line is payable monthly in arrears. In addition, this line of credit required that a percentage of all advances made to CCC be deposited into an account in the name of the bank. This line of credit required CCC to meet certain administrative and financial covenants, including the maintenance of a minimum net worth, ratio of total indebtedness to net worth, limitation on permitted subordinated debt and profitability covenants as defined in the agreement. Under the terms of an agreement between CCC and both of the banks with which CCC maintains lines of credit, all payments received from CCC's borrowers except for principal and interest on the guaranteed portion of the loans are transferred into a restricted bank account. CCC cannot use these funds until the end of a calendar month at which time the funds are used to pay required principal and interest to the banks and certain other required payments.

Effective with the Company's acquisition of Commercial Capital, a new line of credit was provided by Deutsche Bank to the successor to Commercial Capital, Newtek Small Business Finance. The aforementioned CCC credit lines were refinanced, with the aforementioned outstanding loan balances aggregating, after accounting for the conversion of \$1,500,000 to preferred stock, \$53,824,492 at December 31, 2002. The new line of credit for \$75 Million expires March 31, 2004 and is guaranteed by Newtek. Newtek Small Business Finance may request an increase in the line of credit, for which Deutsche Bank, in its sole discretion, may increase in total up to \$100 Million. The new Deutsche Bank line has terms and conditions similar to those contained in the Commercial Capital line, described above.

During the year ended December 31, 2002 Newtek generated cash flow primarily from the following sources:

common stock sales, netting \$2,091,000;  
proceeds from issuance of a long-term debt and warrants of \$30,000,000;  
return of investments of approximately \$14,045,000, which was held pending reinvestment;  
interest and dividend income of approximately \$900,000; and  
other income of approximately \$2,733,000, which represents revenue from the company's consolidated partner company entities.  
cash received from acquired companies of approximately \$2,475,000;

The cash was primarily used to:

invest approximately \$16,196,000 (including approximately \$13,861,000 which was consolidated into Newtek's financial statements) in small or early stage businesses; and  
repayment of a note payable-insurance of approximately \$7,034,000.  
purchase insurance coverage to defease the new capco and capco fund debt obligations for approximately \$14,514,000;

During the year ended December 31, 2001 Newtek generated cash flow primarily from the following sources:

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private placement of common stock, netting \$726,000;  
proceeds from issuance of note payable-insurance of \$5,200,000;  
proceeds from a JP Morgan Chase line of credit of \$575,000, with a December 31, 2001  
interest rate of 5%;  
return of investments of \$12,072,000;  
investment income of approximately \$1,845,000; and  
other income of approximately \$448,000.

The cash was primarily used to:

fund distributions to owners of the predecessors of Newtek in lieu of compensation and related  
to passed-through tax liabilities of \$608,000  
invest \$24,588,000 (less \$10,893,000 which was consolidated into Newtek's financial  
statements) in small or early stage businesses; and  
repay to a finance company note payable insurance of approximately \$1,596,000.

As of December 31, 2002, Newtek had approximately \$41,171,000 in cash of which substantially all was restricted for use for capco  
activities.

Newtek will have current working capital requirements associated with operating its current businesses. It is Newtek's intention to acquire  
interests in partner companies through additional capco programs and through acquisitions made by Newtek directly. Newtek's working capital  
requirements may, therefore, increase in the future and require additional external financing. Newtek expects to finance its participation in  
additional capcos and other ventures principally with externally generated funds, which may include:

borrowings under current or future bank facilities; and/or

the sale of equity, equity-related or debt securities on terms and conditions similar to those obtained for similar sales during 2002.

There can be no assurance, however, financing will be available in amounts, at rates or on terms and conditions acceptable to Newtek.

**Income from capco Tax Credits**

In general, the capcos issue debt and equity instruments, to insurance company investors. For a description of the debt and equity  
instruments and warrants issued by Newtek's capcos, see the Company's Notes to the Consolidated Financial Statements. The capcos then make  
targeted investments, as defined under the respective state statutes, with the funds raised. Each capco, has a contractual arrangement with the  
particular state that 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 targeted investments  
in accordance with these requirements, which requirements are consistent with Newtek's overall business strategy of acquiring controlling  
positions in its partner companies. Each capco also has separate, contractual arrangements with the insurance company investors obligating the  
capco to pay interest on the aforementioned debt instruments. The capco may satisfy this interest obligation by delivering the tax credits or  
paying cash. The insurance company investors have the legal right to receive and use the tax credits and would, in turn, use these tax credits to  
reduce their respective state tax liabilities in an amount usually equal to 100% of their investments in the capcos. The tax credits can be utilized  
over a ten-year period at a rate of, usually, 10% per year and in some instances are transferable and can be carried forward.

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

The amount earned and recorded as income is determined by multiplying the total amount of tax credits initially allocated to the capco by the percentage of tax credits immune from recapture (the earned income percentage) under the state statute. The total amount of tax credits allocated to each of the capcos, the required investment percentages, recapture percentages and related earned income percentages, and pertinent dates are summarized as follows:

**The First to Occur**

State Capco or Fund	Total Tax Credits Allocated	Investment Benchmark	Investment Benchmark Date	Decertification Recapture Thresholds	Recapture Percentage	Earned Income Percentage
<b>FLORIDA</b>	\$ 37,384,028	20%	12/31/00	Prior to 20%	100%	0%
<b>Wilshire</b>		30%	12/31/01	After 20 before 30%	70%	30%
<b>Partners (WP)</b>		40%	12/31/02	After 30 before 40%	60%	40%
		50%	12/31/03	After 40 before 50%	50%	50%
				After 50%	0%	100%
<b>NEW YORK</b>	\$ 35,160,202			Prior to 25%	100%	0%
<b>Wilshire</b>		25%	12/21/02	After 25 before 40%	85%	15%
<b>N.Y. Partners III</b>		40%	12/21/03	After 40 before 50%	70%	30%
<b>(WNY III)</b>		50%	12/21/04	After 50%	0%	100%
<b>COLORADO</b>	\$ 16,175,415			Prior to 30%	100%	0%
<b>Statewide Pool</b>		30%	4/22/05	After 30 before 50%	70%	30%
<b>Wilshire Colorado</b>		50%	10/25/07	After 50%	0%	100%
<b>Partners (WC)</b>				Prior to 30%	100%	0%
	\$			After 30 before 50%	70%	30%
<b>COLORADO</b>	5,882,352	30%	4/22/05	After 50%	0%	100%
<b>Rural Pool</b>		50%	10/25/07	After 50%	0%	100%
<b>Wilshire Colorado</b>						
<b>Partners (WC)</b>						
<b>LOUISIANA</b>	\$ 18,040,000			Prior to 30%	100%	0%
<b>Wilshire LA</b>		30%	10/14/02	After 30 before 50%	70%	30%
<b>Advisers(WLA)</b>		50%	10/14/04	After 50%	0%	100%
<b>WISCONSIN</b>	\$ 16,666,667			Prior to 30%	100%	0%
<b>Wilshire</b>		30%	10/25/02	After 30 before 50%	70%	30%
<b>Investors (WI)</b>		50%	10/25/04	After 50%	0%	100%
<b>LOUISIANA</b>	\$ 8,000,000			Prior to 30%	100%	0%
<b>Wilshire</b>		30%	10/15/05	After 30 before 50%	70%	30%
<b>LA Partners III</b>		50%	10/13/07	After 50%	0%	100%
<b>(WLP III)</b>						
<b>NEW YORK</b>	\$ 6,807,866			Prior to 25%	100%	0%
<b>Wilshire</b>		25%	4/7/02	After 25 before 40%	85%	15%

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<b>N.Y. Advisers II</b>		40%	4/7/03	After 40 before	50%	70%	30%
(WLA II)		50%	4/7/04	After 50%		0%	100%
<b>NEW YORK</b>	\$ 3,810,161			Prior to 25%		100%	0%
<b>Wilshire</b>		25%	6/22/00	After 25 before	40%	85%	15%
<b>Advisers(WA)</b>		40%	6/22/01	After 40 before	50%	70%	30%
		50%	6/22/02	After 50%		0%	100%
<b>LOUISIANA</b>	\$ 3,355,000			Prior to 30%		100%	0%
<b>Wilshire</b>		30%	10/13/03	After 30 before	50%	70%	30%
<b>LA Advisers II</b>		50%	10/13/05	After 50%		0%	100%
(WLA II)							

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Under the various state capco provisions there is a difference in the amount of qualified investments made and the amount of income recognized by the respective capcos upon satisfaction of the various benchmarks. The table below relates the investments made, both as percentage of total funds and in dollar amounts, to the income recognized as each benchmark is achieved. In all of these programs, a majority of Newtek's income from the delivery of the tax credits will be recognized no later than five years into the ten-year programs.

State Capco or Fund	Allocated Tax Credits	Investment Benchmark Percentage/Dollars		Earned Income Percentage/Dollars	
<b>FLORIDA</b>	\$ 37,384,028	20%	\$ 7,476,806	30%	\$ 11,215,208
<b>Wilshire Partners (WP)</b>		30%	\$ 11,215,208	40%	\$ 14,953,611
		40%	\$ 14,953,611	50%	\$ 18,692,014
		50%	\$ 18,692,014	100%	\$ 37,384,028
<b>NEW YORK.</b>	\$ 35,160,202	25%	\$ 8,790,051	15%	\$ 5,274,030
<b>Wilshire N.Y Partners III (WNY III)</b>		40%	\$ 14,064,080	30%	\$ 10,548,060
		50%	\$ 17,580,101	100%	\$ 35,160,202
<b>COLORADO</b>	\$ 16,175,415	30%	\$ 4,852,625	20%	\$ 3,235,083
<b>Wilshire Colorado Partners (WC) Statewide Pool</b>		50%	\$ 8,087,708	100%	\$ 16,175,415
<b>COLORADO</b>	\$ 5,882,352	30%	\$ 1,764,706	20%	\$ 1,176,470
<b>Wilshire Colorado Partners (WC) Rural Pool</b>		50%	\$ 2,941,176	100%	\$ 5,882,352
<b>LOUISIANA</b>	\$ 18,040,000	30%	\$ 4,920,000	30%	\$ 5,412,000
<b>Wilshire LA Advisers (WLA)</b>		50%	\$ 8,200,000	100%	\$ 18,040,000
<b>WISCONSIN</b>	\$ 16,666,667	30%	\$ 5,000,000	30%	\$ 5,000,000
<b>Wilshire Investors (WI)</b>		50%	\$ 8,333,334	100%	\$ 16,666,667
<b>LOUISIANA</b>	\$ 8,000,000	30%	\$ 2,400,000	30%	\$ 2,400,000
<b>Wilshire LA Partners III (WLP III)</b>		50%	\$ 4,000,000	100%	\$ 8,000,000
<b>NEW YORK.</b>	\$ 6,807,866	25%	\$ 1,701,967	15%	\$ 1,021,180
<b>Wilshire N.Y Advisers II (WNY II)</b>		40%	\$ 2,723,146	30%	\$ 2,042,360
		50%	\$ 3,403,933	100%	\$ 6,807,866
<b>NEW YORK</b>	\$ 3,810,161	25%	\$ 952,540	15%	\$ 571,524
<b>Wilshire Advisers (WA)</b>		40%	\$ 1,524,064	30%	\$ 1,143,048
		50%	\$ 1,905,081	100%	\$ 3,810,161
<b>LOUISIANA</b>	\$ 3,355,000	30%	\$ 915,000	30%	\$ 1,006,500
<b>Wilshire LA Advisers II (WLA II)</b>		50%	\$ 1,525,000	100%	\$ 3,355,000

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During the years ended December 31, 2002 and 2001, the capcos satisfied certain investment benchmarks and the related recapture percentage requirements and accordingly, earned a portion of the tax credits. In addition, in both 2002 and 2001 Newtek recognized income from tax credits in prior years resulting from the accretion of the discount attributable to tax credits earned in prior years. See the Company's Notes to Consolidated Financial Statements.

During 2002, Newtek established and received certification for two new capcos, Wilshire Colorado and Wilshire Louisiana Partners III.

**Impact of Inflation**

The impact of inflation on Newtek's results of operations is not material.

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**Item 7. FINANCIAL STATEMENTS**

**INDEX TO NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES  
FINANCIAL STATEMENTS**

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**Report of Independent Accountants**

To the Board of Directors and Stockholders of Newtek Business Services, Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, changes in stockholders' equity and cash flows present fairly, in all material respects, the financial position of Newtek Business Services, Inc. and its subsidiaries at December 31, 2002 and 2001, and the results of their operations and their cash flows for the years ended December 31, 2002 and 2001 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PRICEWATERHOUSECOOPERS LLP

/s/ PRICEWATERHOUSECOOPERS LLP

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**New York, New York  
February 28, 2003**

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**NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**DECEMBER 31, 2002 AND 2001**

	<b>2002</b>	<b>2001</b>
<b>A S S E T S</b>		
Cash and Cash equivalents	\$ 41,171,358	\$ 31,171,966
Credits in lieu of cash	41,580,950	21,810,776
Loans receivable	56,073,016	
Accounts receivable, (net of allowance of \$34,466 in 2002)	661,351	198,572
Receivable from bank	2,938,309	
Accrued interest receivable	285,151	
Investments in qualified businesses held to maturity investments	3,962,353	12,173,884
Investments in qualified businesses equity method investments	1,091,110	2,276,344
Structured insurance product	2,893,301	2,731,894
Prepaid insurance	14,056,196	10,820,841
Prepaid expenses and other assets	932,447	754,570
Furniture, fixtures and equipment, (net of accumulated depreciation of \$190,590 and \$18,957, respectively)	546,231	128,290
Goodwill	2,862,965	963,736
Asset held for sale		331,929
<b>Total assets</b>	<b>\$ 169,054,738</b>	<b>\$ 83,362,802</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Liabilities:		
Accounts payable and accrued expenses	\$ 4,218,367	\$ 1,541,359
Notes payable certified investors	3,844,181	3,858,389
Notes payable insurance	5,369,896	9,404,032
Notes payable other	480,500	
Borrowings under line of credit	450,000	575,000
Bank notes payable	53,824,492	
Interest payable in credits in lieu of cash	65,196,116	49,640,846
Mortgage payable		306,929
Deferred tax liability	3,726,151	1,563,018
<b>Total liabilities</b>	<b>137,109,703</b>	<b>66,889,573</b>
Minority interest	4,772,741	5,081,692
Commitments and contingencies		
Stockholders equity:		
Common stock (par value \$0.02 per share; authorized 39,000,000 shares, Issued and outstanding 25,341,428 and 22,212,517)	506,828	444,250
Additional paid-in capital	20,992,827	13,442,899
Retained earnings (accumulated deficit)	5,672,639	(2,495,612)

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Total stockholders' equity	27,172,294	11,391,537
Total liabilities and stockholders' equity	\$ 169,054,738	\$ 83,362,802

See accompanying notes to these consolidated financial statements.

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**NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**FOR THE YEARS ENDED DECEMBER 31, 2002 AND DECEMBER 31, 2001**

	<u>2002</u>	<u>2001</u>
<b>Revenue:</b>		
Income from tax credits	\$ 30,603,046	\$ 21,497,956
Consulting fee income	387,604	9,236
Interest and dividend income	900,127	1,845,238
Other Income	2,733,374	447,756
	<b>_____</b>	<b>_____</b>
Total revenue	34,624,151	23,800,186
<b>Expenses:</b>		
Interest	11,485,367	11,577,169
Payroll and consulting fees	4,565,954	2,664,716
Professional fees	3,145,246	2,060,635
Insurance	1,951,248	1,529,688
Other	3,672,362	1,175,451
	<b>_____</b>	<b>_____</b>
Total expenses	24,820,177	19,007,659
<b>Income before other than temporary decline in value of investments, gain on sale of property, write-down of asset held for sale to net realizable value, equity in net losses of affiliates, minority interest, provision for income taxes, extraordinary gain on acquisition of minority interest and extraordinary gain on acquisition of a business</b>		
	9,803,974	4,792,527
Other than temporary decline in value of investments (net of \$28,635 recovery in 2002)	(1,573,730)	(371,645)
Gain on sale of property	16,841	
Write-down of asset held for sale to net realizable value		(168,071)
Equity in net losses of affiliates	(729,109)	(2,279,852)
	<b>_____</b>	<b>_____</b>
<b>Income before minority interest, provision for income taxes, extraordinary gain on acquisition of minority interest and extraordinary gain on acquisition of a business</b>	7,517,976	1,972,959
Minority interest	(335,324)	(508,783)
	<b>_____</b>	<b>_____</b>
<b>Income before provision for income taxes, extraordinary gain on acquisition of minority interest and extraordinary gain on acquisition of a business</b>	7,182,652	1,464,176
Provision for income taxes	(2,657,410)	(534,616)
	<b>_____</b>	<b>_____</b>
<b>Income before extraordinary gain on acquisition of minority interest and extraordinary gain on acquisition of a business</b>	4,525,242	929,560
Extraordinary gain on acquisition of minority interests	907,766	
Extraordinary gain on acquisition of a business	2,735,243	
	<b>_____</b>	<b>_____</b>
<b>Net income</b>	<b>\$ 8,168,251</b>	<b>\$ 929,560</b>
	<b>_____</b>	<b>_____</b>

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Weighted average common shares outstanding			
Basic		24,183,501	21,889,958
Diluted		24,293,540	21,909,527
Income per share after extraordinary gain			
Basic	\$	.34	\$ .04
Diluted	\$	.34	\$ .04
Income per share before extraordinary gain			
Basic	\$	.19	\$ .04
Diluted	\$	.19	\$ .04

See accompanying notes to these consolidated financial statements.

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**NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2002 AND DECEMBER 31, 2001**

	Shares		Common Stock		Additional Paid-in -Capital		(Accumulated Deficit) Retained Earnings		Total
Balance at December 31, 2000	21,373,460	\$	427,469	\$	12,267,052	\$	(3,425,172)	\$	9,269,349
Issuance of Common Stock and Warrants	839,057		16,781		1,745,413				1,762,194
Distributions to Capco members					(607,542)				(607,542)
Issuance of stock options to non-employees					37,976				37,976
Net Income							929,560		929,560
Balance at December 31, 2001	22,212,517	\$	444,250	\$	13,442,899	\$	(2,495,612)	\$	11,391,537
Issuance of Common Stock	3,080,341		61,607		6,810,504				6,872,111
Issuance of stock options to non-employees					89,134				89,134
Issuance of common stock to employees and consultants	48,570		971		139,459				140,430
Issuance of warrants					510,831				510,831
Net income							8,168,251		8,168,251
Balance at December 31, 2002	25,341,428	\$	506,828	\$	20,992,827	\$	5,672,639	\$	27,172,294

See accompanying notes to these consolidated financial statements.

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**NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2002 AND DECEMBER 31, 2001**

	<u>2002</u>	<u>2001</u>
Cash flows from operating activities:		
Net income	\$ 8,168,251	\$ 929,560
Adjustments to reconcile net income to net cash used in operating activities:		
Other than temporary decline in value of investments	1,573,730	371,645
Write-down of asset held for sale to net realizable value		168,071
Equity in losses of affiliates	729,109	2,279,852
Extraordinary gain on acquisition of minority interests	(907,766)	
Extraordinary gain on acquisition of subsidiary	(2,735,243)	
Gain on sale of asset held for sale	(16,841)	
Loss on disposition of assets	39,725	
Income from tax credits	(30,603,046)	(21,497,956)
Deferred income taxes	2,657,410	534,616
Depreciation and amortization	147,681	74,054
Provision for doubtful accounts	34,466	
Accretion of interest income	(175,615)	(161,407)
Accretion of interest expense	10,732,980	10,676,928
Issuance of stock for services performed	140,430	58,800
Non cash compensation	89,134	37,976
Minority interest	335,324	508,783
Changes in assets and liabilities, net of the effect of business acquisitions:		
Prepaid insurance	506,227	1,366,535
Prepaid expenses, accounts receivable and other assets	(247,975)	(179,231)
Accounts payable and accrued expenses	(376,122)	(1,005,441)
Net cash used in operating activities	<u>(9,908,141)</u>	<u>(5,837,215)</u>
Cash flows from investing activities:		
Investments in qualified businesses (held to maturity investments)	(2,334,724)	(12,559,893)
Investments in qualified businesses (equity method investments)		(900,000)
Investments in qualified businesses (consolidated entities)	(13,860,832)	(11,128,283)
Other investments		(489,500)
Return of investments held to maturity investments	8,742,909	11,862,284
Return of investments consolidated entities	5,302,583	210,000
Consolidation of majority owned entities	8,871,734	10,893,283
Cash received from Exponential acquisition	106,642	
Cash received from Commercial Capital Corp. acquisition	2,367,870	
Distributions from equity method investees		240,399
Purchase of furniture, fixtures and equipment	(279,438)	(107,361)
Proceeds from sale of property	348,770	
Net cash provided by (used in) investing activities	<u>9,265,514</u>	<u>(1,979,071)</u>

See accompanying notes to these consolidated financial statements.



**Table of Contents****NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)****FOR THE YEARS ENDED DECEMBER 31, 2002 AND DECEMBER 31, 2001**

	<u>2002</u>	<u>2001</u>
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	\$ 29,999,543	\$
Payments for defeasance of long-term debt	(14,513,665)	
Proceeds from issuance of note payable-insurance		5,200,000
Principal payments of note payable-insurance	(7,034,136)	(1,595,968)
Proceeds from (payments of) note payable bank	(125,000)	575,000
Proceeds from issuance of notes other	480,500	
Purchase of minority interest from member		(1,300)
Principal payment of mortgage payable	(306,929)	(62,410)
Contributions from minority members	50,500	57,000
Distributions to members		(607,542)
Net proceeds from issuance of common stock	1,371,249	726,391
Proceeds from issuance of common stock to certified investors	719,957	
	<u>10,642,019</u>	<u>4,291,171</u>
Net cash provided by financing activities		
Net increase (decrease) in cash and cash equivalents	9,999,392	(3,525,115)
Cash and cash equivalents beginning of year	31,171,966	34,697,081
Cash and cash equivalents end of year	<u>\$ 41,171,358</u>	<u>\$ 31,171,966</u>
<b>Supplemental disclosure of cash flow activities:</b>		
Cash paid for interest	\$ 953,073	\$ 399,285
Issuance of notes in partial payment for insurance	\$ 3,000,000	\$
Fixed assets acquired under capital lease obligations	\$ 147,738	\$
Reduction of credits in lieu of cash and interest payable in credits in lieu of cash balances due to delivery of tax credits to Certified Investors	\$ 10,832,872	\$ 17,183,989
Issuance of common stock in connection with acquisition of Commercial Capital Corp.	\$ 900,194	\$
Issuance of common stock in connection with acquisition of Exponential	\$ 988,750	\$
Issuance of warrant in connection with purchase of Coverage A Insurance	\$ 510,831	\$
Consolidation of investments previously accounted for under the equity or cost method	\$ 537,083	\$

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See accompanying notes to these consolidated financial statements.

**Table of Contents****NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)****FOR THE YEARS ENDED DECEMBER 31, 2002 AND DECEMBER 31, 2001**

	<u>2002</u>	<u>2001</u>
Acquisition of Capcos minority interests resulting in goodwill:		
Newtek Business Services common stock issued	\$ 1,951,168	\$ 978,303
Less: Deferred tax benefit acquired	14,873	
Less: Minority interests acquired	887,652	
	<u>                    </u>	<u>                    </u>
Goodwill recognized	\$ 1,048,643	\$ 978,303
	<u>                    </u>	<u>                    </u>
Acquisition of Capcos minority interests resulting in extraordinary gain:		
Minority interests acquired	\$ 1,369,156	\$
Add: Deferred t		