

NEWTEK BUSINESS SERVICES INC
Form 10KSB
March 31, 2003
Table of Contents

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

(State or other jurisdiction of incorporation or organization)

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

100 Quentin Roosevelt Boulevard Suite 408 Garden City NY

11530

(Address of principal executive offices)

(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

(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.

Table of Contents

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

Table of Contents

Table of Contents

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.

Table of Contents

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

Table of Contents

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

Table of Contents

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

Table of Contents

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
Total 1998		\$ 1,647,905	\$ 157,694
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
Total 1999		\$ 41,389,998	\$ 8,545,475
WNYII	April 2000	\$ 5,019,803	\$ 504,745
WA	May 2000	\$ 661,432	\$ 160,068
WLP II	October 2000	\$ 2,456,565	\$ 319,958
WNYIII	December 2000	\$ 29,052,790	\$ 4,137,438
Total 2000		\$ 37,190,590	\$ 5,122,209
Colorado	April 2002	\$ 11,654,021	\$ 3,604,978
WLP III	October 2002	\$ 2,859,644	\$ 1,089,134
Total 2002		\$ 14,513,665	\$ 4,694,112

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

Table of Contents

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

Table of Contents

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

Table of Contents

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

Table of Contents

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

Table of Contents

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

Table of Contents

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
Total Assets	\$ 464,034	\$ 1,756,291	\$ 3,251,065	(a)	\$ 436,567	\$ 3,456,416	\$ 732,102	\$ 1,278,340	\$ 700,130	\$ 1,845,586
Current Liabilities	\$ 33,006	\$ 53,026	\$ 14,433	(a)	\$ 108,554	\$ 51,630				