NEWTEK BUSINESS SERVICES INC
Form 10-K
May 10, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2005

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.)**
462 Seventh Avenue, 14th floor	
New York, New York	**10018**
(Address of principal executive offices)	**(Zip Code)**

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

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

Common Shares, par value $0.02 per share

(Title of class)

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 x

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-K 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-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is an accelerated filer, a large accelerated filer or a non-accelerated filer (all as defined in Rule 12b-2 of the Act).

Accelerated filer ¨ Large Accelerated filer ¨ Non-accelerated filer x

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

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 June 30, 2005, was approximately $53,510,000.

As of May 8, 2006 there were 34,867,207 shares issued and outstanding of the registrant s Common Shares, par value $0.02 per share.

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PART I

Item 1 BUSINESS
Overview

Newtek Business Services, Inc. (Newtek) is a holding company for several wholly- and majority-owned operating subsidiaries, including 15 certified capital companies (excluding the sixteenth capco, Exponential of New York, LLC which is managed, but not consolidated by Newtek) which we refer to as capcos, and several portfolio companies in which the capcos own non-controlling interests. Newtek s goal is to provide a variety of financial products and business services to small and medium-sized businesses and has, historically, when possible and feasible used the funding available through the capcos to support this goal. The U.S. Small Business Administration, or SBA, estimates that there are 23 million small and medium-sized businesses and we are a direct distribution channel into that market. We currently operate in five principal lines of business and in two additional complementary lines of business. These seven lines of business are as follows:

Small business loans through participation in the SBA program. Through one of our operating subsidiaries, Newtek Small Business Finance, Inc., or NSBF, we make small business loans guaranteed by the SBA. Our business clients use the loan proceeds to acquire commercial real estate, machinery, equipment and inventory, to refinance debt, to fund franchises, to acquire businesses and for working capital. NSBF is one of 14 non-banking companies SBA licensed to provide SBA loans nationwide under the federal section 7(a) loan program for small businesses . John Cox, who spent 30 years at the SBA and was previously Associate Administrator for Financial Assistance, the senior official in charge of SBA lending, is Chairman and a founder of NSBF. NSBF funded $58 million in loans in 2005, compared to $52 million in 2004. NSBF has received Preferred Lenders Program (PLP) status in the vast majority of districts, a designation whereby the SBA authorizes the most experienced SBA lenders to place SBA guarantees on loans without seeking prior SBA review and approval. Being a national lender, PLP status allows Newtek Small Business Finance to serve its clients in an expedited manner since it is not required to present individual applications to SBA offices.

Electronic payment processing services. Newtek Merchant Solutions- WI and Newtek Merchant Solutions-FL (the two largest in the segment) offer credit card, debit card and gift card processing services and check approval services to over 11,000 small and medium-sized businesses in conjunction with our full service processing center in Wisconsin. In addition, Newtek Merchant Solutions provides these services to the customers of our alliance partners, credit unions and local and regional banks in various parts of the country.

Web hosting Services. We acquired CrystalTech Web Hosting Inc., or CrystalTech, in July 2004. CrystalTech provides both shared and dedicated hosting offerings to individuals and entities that desire to have a presence on the Internet. CrystalTech was servicing over 46,000 customers at December 31, 2005 and was the 2nd largest web hosting company exclusively utilizing Windows® based technology. In 2005 CrystalTech began the development of Linux-based hosting services and data storage services which are expected to be operational in 2006.

Small Business Insurance. The Newtek Insurance Agency was created during 2004 through the acquisition of an insurance agency spin-off from a major international insurance company. The agency is licensed in 49 states and offers commercial and personal lines of insurance. Commercial product lines include property, casualty, workmen s compensation, business owner protection, errors & omissions, directors and officers liability, and health insurance. The personal product lines include life, auto, homeowners and disability, which are offered through our proprietary web-based platform. In addition, using our proprietary operating and processing system Financial Keyosk, it currently provides insurance products and back office support for 11 community banks and credit unions and recently initiated a program to handle referrals from the Navy Federal Credit Union, the country s largest in terms of members and deposits, for personal homeowners insurance and commercial lines of insurance for its members with small to medium-sized businesses. The Newtek Insurance Agency serves approximately 4,000 policyholders.

Certified capital companies. We have financed our operations and derived a material portion of our revenue and net income from state-sponsored capco programs and other related investments and operations. However, capco revenues have declined as a percentage of our total revenues and we see this trend as continuing and accelerating. A capco is a company we create pursuant to a state sponsored program, which is designed to encourage investment in small and new businesses and to create economic activity and jobs in the state. As an inducement to participation in the capco programs, each state provides a capco with tax credits to issue to its investors, which must be insurance companies. The tax credits are designed to be used to reduce the payment of taxes by the holder of those credits in the sponsoring state. The revenue to us resulting from the capco tax credits is non-cash as we receive the cash up-front through the monetization of the tax credits through the sale of notes, and is used exclusively to satisfy obligations of the capcos to deliver tax credits to their investors. Until our capcos have completed their business cycles and invested all of their funds, and we are able to distribute cash earnings of our capco businesses to the holding company, we must rely on the capco management fees and earnings of non-capco investments as the sources of cash to meet our expenses. We have deemphasized the capco portion of our business due both to a decline in new capco programs and the growing emphasis on developing our operating businesses.

In addition, we are continuing to build two other businesses:

small business financial and management reporting and planning systems conducted by *Newtek Financial Information Services*, and

small business tax services provided by *Newtek Tax Services, LLC*.

Business Strategy

Key elements of our strategy to grow our business are:

Continue to focus our business model to serve the small and medium-sized business market. Over the last three years, we have refined our business model to focus primarily on developing and marketing products and services aimed at small and medium-sized businesses similar to those which we initially funded through our participation in capco programs. As our service offerings grow and diversify, we continue to reduce our dependence on the capco programs for investment funding and revenue. We are now providing one or more services to approximately 61,000 small business customers.

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Further develop national marketing of the Newtek brand through our alliance partners. We have formed key marketing alliances with national business organizations such as Merrill Lynch, Navy Federal Credit Union and UBS, Inc., and trade organizations such as the Credit Union National Association and the General Motors Minority Dealers Association, and affinity organizations such as the U. S. Women s Chamber of Commerce, the semi-public Veterans Corporation of America and National Physicians Care, Inc. These alliance partners rely heavily on information and processing capabilities available through our referral system and, through their customers, members and participants, generate small business lending, insurance and payment processing business for us and build awareness of our brand name.

Continue to develop our state-of-the-art technology to process business applications and financial transactions. Our proprietary referral system allows us to process new business utilizing a web-based, centralized processing point. Our trained representatives use these web-based applications as a tool to acquire and process data through telephonic interviews, eliminating the need for face to face contact and the requirement that a customer complete multiple paper forms or data entry for multiple product lines. This approach is customer friendly, allows us to process applications very efficiently and allows us to store client information for further processing and cross-selling efforts while offering what we believe to be the highest level of customer service. Most importantly, it means that our cost for acquiring each new customer is very low. It also assures our alliance partners full transaction transparency with the highest level of customer service. This system permits our alliance partners to have a window open to our back office processing 24 hours a day, 7 days a week, to see every communication and interaction between our sales and processing representatives and their referred customers.

Cross sell additional products and services to small and medium-sized businesses. Our processing systems have been developed to facilitate cross selling multiple products and services. To date we have not fully implemented this strategy but we are planning to do so during the second half of 2006 and in 2007.

Opportunistically acquire companies or assets to provide complementary products and services. By strategically acquiring companies or assets in our primary product and service markets, we can expand our customer base and create cross-selling opportunities for our growing suite of complementary goods and services. During 2004, CrystalTech was acquired in this manner.

Continue to fulfill our obligations under the current capco programs. During 2005, we raised approximately $20 million in new capco funding (net of credit enhancement costs) in New York and Texas. However, we do not see many opportunities for new capco programs. Our emphasis is on continuing our exemplary regulatory compliance program in order to successfully complete the investment cycles for all capcos. At December 31, 2005, we had reached the final investment requirements in 14 of 16 capco programs in which we participate, which includes Exponential of New York, LLC and ensured that 95% of the tax credits are beyond risk of recapture. In addition, we expect to reach full or 100% investment in two of our capcos during 2006 which will enable us to consider the distribution of any earnings or gains (net of any obligations we may have to the respective states at that point).

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Financial Highlights

During our year ended December 31, 2005:

- The operation of the capcos resulted in non-cash revenues related to the capco tax credits of $37 million, or 38% of total revenue.

- During 2005 all of our companies generated $97 million in revenue; the three principal companies were: Newtek Small Business Finance with $11 million, an increase of 3% over the previous year, Newtek Merchant Services with $31 million, an increase of 72% over the previous year and CrystalTech, with $11 million, an increase of 31% over the prior comparative year (including six months which we did not own the business).

- During 2005 Newtek Small Business Finance arranged to replace the one year Deutsche Bank warehouse credit facility with a three year, $75 million revolving credit agreement with General Electric Capital Corporation.

- During 2005 we created 2 new capcos raising $20 million in new funds net of credit enhancement costs. We also reached the end of the investment cycle, at 100% invested, for our first capco and are moving to decertify it voluntarily.

We have experienced significant growth since 2000, our first year as a publicly traded company. The following highlights illustrate our growth in revenues and net income over the five year period of 2001 - 2005.

- During 2005 our Shareholders Equity continued to grow to $87 million or $2.51 per common share outstanding at December 31, 2005, an increase of 13% over December 31, 2004, and an increase of 667% over our Shareholders Equity reported at December 31, 2000.

- For the year ended December 31, 2000, our total revenue was $9 million, compared to total revenues of $97 million for the year ended December 31, 2005, an increase of 967%.

- For the year ended December 31, 2000, we incurred a loss of $3 million, compared to net income of $8 million for the year ended December 31, 2005.

During 2005, our capcos invested an aggregate of $27 million in qualified businesses. Since beginning business in 1998, our capcos have invested an aggregate of $118 million, against which $6 million has been determined to be impaired.

Principal Operating Businesses

The manner in which we own and manage our operating, non-capco lines of business can be divided broadly into three categories: (1) those which are majority-owned and controlled, (2) those which we either primarily control through lesser equity positions or contractual rights and (3) those in which we have a passive or venture-type investments. At December 31, 2005, we had 36 majority-owned companies which were a result of investments through the capco programs. All of the businesses which were initially financed primarily by capco funding are located and operated by business professionals located in the respective states but are assisted and guided by management of the holding company, Newtek. Primarily controlled and passive or venture capital investments are discussed below under Other Business Lines.

The Newtek Referral System

Each of the operating businesses benefit from the receipt of significant numbers of customer referrals from our alliance partners, pursuant to agreements negotiated and structured by our holding company management and staff. Since 2003, we have increased our focus on using strategic business affiliations to identify likely small to mid-sized business customers and others to be serviced by our operating businesses. Our proprietary, internally-developed referral system has undergone years of

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development and testing and is now operating as intended. In response, we have increased our efforts to ally Newtek with companies and organizations that wish to offer one or more of our principal business lines to their customers or members. These alliance partners are able to provide greater service to their customers and members and derive a steady flow of referral payments from us. On the other hand, our operating companies are receiving significant numbers of referrals for our services in the areas of small business loans, insurance and electronic payment processing and are thus acquiring customers at a low cost. The referral system technology facilitates this transfer of information but it has another important feature: it permits our customer service representatives, their supervisors and the referring alliance partners to all observe the real time processing of each referral, from intake to completion. For a Merrill Lynch financial advisor who refers a customer for an SBA loan or electronic payment processing, he or she can follow the processing and know when decisions are made, what they are, when the referral fees are earned as well as observe and manage the operational performance of our customer service representatives. The process is analogous to the bar code system used by overnight delivery services to track the movement of a package, where critical processing points are input and the customer is able to access the company s password-protected web site and monitor the movement of the package from pick up to delivery.

We have entered into strategic alliance agreements for one or more business services with the following entities:

Merrill Lynch

Credit Union National Association

National Physicians Care, Inc.

Navy Federal Credit Union

The Veterans Corporation of America

The U.S. Women s Chamber of Commerce

three New York City associations of retail and wholesale small and mid-sized businesses.

During 2005 we have used our referral system to intake referrals and close sales as follows:

our small business lender received 3,909 referrals for $955,452,856 of loan volume from all sources;

our electronic payment processor received 4,629 referrals from all sources; and

our insurance agency received 1,543 referrals from all sources.

Primary Business Segments and Investments

Small Business Lending

We acquired an 80% interest in Newtek Small Business Finance, Inc., or NSBF, on December 31, 2002 through a combination of capco funding and cash and non-cash resources that we provided; the balance of the equity is held by CS First Boston Management, Inc.

NSBF specializes in making, servicing and selling small business loans guaranteed by the SBA for the purpose of acquiring commercial real estate, machinery, equipment and inventory and to refinance debt, fund franchises, working capital and business acquisitions. NSBF is one of 14 non-banking companies SBA licensed as a Small Business Loan Corporation to provide loans nationwide under the federal section 7(a) loan program for small businesses. This federal program is authorized each year by Congress to guaranty small business loans in an amount determined by Congress. The authorization for 2006 was $17 billion. NSBF has received preferred lenders program (PLP) status, a designation whereby the SBA authorizes the most experienced SBA lenders to place SBA guarantees on loans without seeking prior SBA review and approval. Being a national lender, PLP status allows Newtek Small Business Finance to serve its clients in an expedited manner since it is not required to present applications to individual SBA offices. The operations of NSBF are heavily dependent on the nature of the regulations imposed on it as a small business lending company and its ability to remain in compliance with those regulations.

Prior to our acquisition and recapitalization of NSBF, this small business lender had been poorly managed and plagued by bad loans. When we purchased NSBF it had negative shareholders equity. Over the course of the previous two years, we and the new NSBF management team have carefully reviewed the problems and prepared a detailed plan for the operations of the company post-closing During 2005 NSBF entered into a 3 year revolving credit facility with General Electric Capital Corporation which replaced the Deutsche Bank line. This new 3 year facility will provide longer term and more stable funding for the company s lending and is guaranteed by Newtek.

During 2005, NSBF funded 165 loans for a total of $58 million, and was servicing a portfolio of loans for others at December 31, 2005 totaling $176 million and servicing its own portfolio of $37 million aggregating $213 million of loan servicing in total. NSBF reported pre-tax loss for 2005 of $28,000 on a segment basis.

Electronic Payment Processing

We conduct our electronic payment processing business nationwide primarily through 7 companies which offer credit card, debit card and gift card processing services and check approval services to over 11,000 small businesses at December 31, 2005 and processed transactions at an annualized rate exceeding $2 billion.

Universal Processing Services - Wisconsin, LLC, d/b/a Newtek Merchant Solutions of Wisconsin, or UPS-WI, provides credit card, debit card, gift card processing and check approval services directly to merchants. UPS-WI obtains the majority of its merchant customers through the Newtek referral system and its agreements with Alliance partners, agreements with independent sales organizations, including our affiliates below, and other associations throughout the country which then contract with UPS-WI to provide processing services. UPS-WI pays these organizations and associations a percentage of the processing revenue derived from their respective merchants. UPS-WI in turn contracts with large scale data processing companies to provide the actual data processing and funds settlement services for the 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. On a wholesale basis, UPS-WI acts as a processor for merchants that are brought to it through our alliance partners, affiliated companies and other third-party marketing organizations. UPS-WI had contracts with 140 independent sales consultants as of December 31, 2005, and has grown its customer base significantly during each year of operations since 2002. UPS-WI is currently adding approximately 300 customers per month, and has reached a customer base of approximately 7,600 as of December 31, 2005. UPS-WI had positive cash flow and earnings for the year and processed transactions at an annualized rate of approximately $1.2 billion.

The following three subsidiaries operate under the name Newtek Merchant Solutions :

Universal Processing Services, LLC, d/b/a Newtek Merchant Solutions of New York was organized in March 2001 and is based in New York City.

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Universal Processing Services - Colorado, LLC, d/b/a Newtek Merchant Solutions of Colorado, was organized in December 2002 and is based in Evergreen, Colorado.

First BankCard Alliance Alabama, LLC, d/b/a Newtek Merchant Solutions of Alabama, was organized in 2004 and is based in Montgomery, Alabama.

Each of these affiliates markets credit and debit card processing services, check approval services and ancillary processing equipment and software to merchants who accept credit cards, debit cards, checks and other non-cash forms of payment. Each also contracts with local independent representatives to sell and service payment processing services. In addition to marketing these services to local markets, each company is currently establishing relationships with local and regional banks that do not offer their own merchant processing in order to enable them to offer these services to their clients through Newtek Merchant Solutions. Each contract for the actual processing services provided to its merchants and customers through an agreement with UPS-WI. Each of these Newtek Merchant Solutions companies has steadily increased the number of customers and has experienced a continued increase in its receipt of monthly residual payments and all but one have now achieved profitability.

Newtek Merchant Services Florida (formerly doing business as Automated Merchant Services, Inc.), or NMS-FL, was acquired by our Florida capco and us in August 2003 for a combination of cash and shares. As do our other electronic payment processing affiliates, NMS-FL also provides electronic payment services, hardware and software to approximately 3,400 businesses and government agencies through sales representatives covering the Florida marketplace. We are assisting NMS-FL to grow beyond the Florida market and to expand its product base to include all of the products and services that our existing processor, UPS-WI, offers. During 2005 Automated Merchant Services was re-branded NMS-FL and is now marketed in conjunction with our other business services and financial products.

During 2004, NMS-FL entered into an exclusive agreement with Citibank to provide an outsourced merchant processing service to referrals from the 116 Citibank branches in Illinois, Florida and the District of Columbia. This relationship was profitable for the company but was terminated late in 2005 due to the sale by Citibank of this portion of its business to a competitor, First Data Resources. NMS-FL was bought out of the contract rights it had at a favorable price and recorded a gain of $700,000, less commissions of $156,000.

All of our electronic payment processing businesses rely on the ability to obtain actual data processing services from organizations equipped to perform the large volume of highly sophisticated data processing operations. There are two aspects to the processing: the initial authorization of a payment (referred to as the front end processing) and the merchant credit and cardholder charge transaction (the back end processing). Our payment processing businesses rely on up to 5 of each of the front end and back end processors which means that our risk of reliance on any one company is reduced and also gives us the option of utilizing different processors to match the needs of particular customers or situations.

As a result of the exposure of these companies to liability for merchant fraud, chargebacks and other losses inherent in the merchant payment processing business, our operating companies have developed practices and policies which attempt to assess and counter these risks. Activities which we engage in order to mitigate such risks are:

- underwriting the initial application of a merchant to identify unusual risks, structure the relationship in a manner consistent with acceptable risks and in almost all cases obtaining a personal guarantee from the merchant;

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monitoring the daily and monthly activity of each merchant to identify any departures from normative charging behavior of each merchant, monitoring the largest of our merchants and those with high levels of refunds or chargebacks, so as to ensure an opportunity to address any credit or chargeback problems at the earliest possible time; and

requiring all of our merchants to agree to the establishment of cash reserves to protect us against merchant failures to pay for chargebacks and other fees, and making adjustments in these reserves as merchant experience indicates.

We believe that these procedures will enable our electronic payment processing subsidiaries to avoid most material problems related to merchant or customer fraud and similar potential losses. The development and growth of this business will be primarily through customers identified for us by our alliance partners and to a much lesser extent by our independent representatives.

Website Hosting Services

Since acquiring CrystalTech Web Hosting, Inc. in 2004 we have been engaged in the business of providing website hosting services to what is now more than 46,000 customers. Founded in 1997, CrystalTech provides simple shared hosting plans and more complex dedicated hosting plans, for which it receives recurring monthly fees, as well as other fees such as set-up fees, consulting fees, domain name registrations and others.

CrystalTech s dedication to superior customer service is reflected in the growth of its customer base, from approximately 3,900 customers in 2001 to approximately 46,000 at the end of 2005. CrystalTech currently uses only Microsoft Windows® technology. Microsoft has described CrystalTech as the second largest hosting service in the world providing exclusively Microsoft Windows 2003® hosting. Because of the efficiency of CrystalTech s operations and its firm commitment to customer service, CrystalTech has been able to build a business with significant growth in its customer base and increasing positive cash flow and profitability. During 2005 CrystalTech earned pre-tax income of $4 million on revenue of $11 million.

CrystalTech recently announced that it has implemented a program to add Linux-based web hosting and web-based data storage and back-up services to its product line, both of which it expects will be operational during the second half of 2006. All of the growth in customers by CrystalTech has come as a result of customer referrals without any material expenditures for marketing or advertising. Many of CrystalTech s competitors are very price sensitive, offering minimal services at cut-rate pricing. CrystalTech has instead emphasized higher quality service with fair but reasonable monthly fees. CrystalTech operates currently one network control center in Phoenix, Arizona of 2,500 square feet and in which are installed numerous redundant systems to afford customers the greatest level of protection from network failures.

Financial Information Systems

We have two companies which are engaged in the design and implementation of financial and management reporting systems and providing outsourced financial management functions:

Group Management Technologies, LLC, d/b/a Newtek Financial Information Systems of Florida, or GMT, 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 that reduce costs and management

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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 effectively grow the business. 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.

Small Business Tax Services

Newtek Tax, LLC was formed in 2003 to provide tax filing, preparation and advisory services to small and medium sized businesses. Newtek Tax provides comprehensive tax services that are customized to fit the unique needs of each client. With specialists available in many different areas of tax-related expertise, we believe that Newtek Tax offers a significant depth of resources. Newtek Tax has licensed what it believes to be state-of-the-art software to prepare returns. We continue to work with the management of this company to develop and implement its business model and improve its financial results however it has yet to become profitable or cash flow positive.

Small Business Insurance Products and Services

Newtek Insurance Agency, LLC- During 2005 we consolidated the businesses of our two insurance agencies. National Insurance Solutions, LLC was funded in 2005 in Washington, D.C. and in 2004 we acquired Vistar Insurance Services, Inc. in Central City, Colorado. Vistar was an existing business with a modest revenue of insurance commissions derived mostly from sales through cooperative operations with banks and credit unions. During 2005 operations of Vistar resulted in a loss of $1 million during the first nine months of the year, and in order to avoid a more serious liquidity problem, the assets were put up for sale and ultimately purchased by an affiliate, which we facilitated by the issuance of $1 Million worth of our common shares. The result is that our insurance business is now consolidated under the name of Newtek Insurance Agency, LLC which has begun to implement our business plan. Our plans are for this nationally licensed insurance agency to serve as a retail and wholesale agency specializing in the marketing of personal and commercial lines insurance products to customers of all our affiliated companies as well as our alliance partners. During 2005, we have been able to arrange some new affiliations for Newtek Insurance enabling it to receive many good sales leads through referrals. For example, in early 2006 we implemented a program with the Navy Federal Credit Union to market commercial and homeowners insurance to their 2.5 million members in reliance on the benefits of our proprietary referral system and financial keyosk operating system.

Other Business Lines

Exponential Business Development Company, Inc., or Exponential, was originally organized in the mid-1990s to participate in the New York capco program (as a competitor of Newtek). It had structured Exponential, LLC, differently than us, with ownership being sold to the insurance company investor and a small equity portion retained by Exponential, which acted as the manager. The capco has made 11 small equity investments and 5 additional investments of both debt and equity. Exponential has also organized another investment vehicle Exponential of New York, LP, that has made six equity investments and two others involving debt. Our interest in Exponential 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.

We have also made investments, usually smaller or in the form of debt, in a number of other companies. We are generally not actively involved in the management or day-to-day operations of companies in which our equity ownership and voting power is less than 25%. Instead, we offer these businesses advisory services or assistance with particular projects, as well as the collaborative services

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of our affiliated companies. In pursuing business objectives, we intend to hold a decreasing portion of our total assets in companies in which we have voting power of less than 25 percent.

Finally, a number of companies which we have invested in through our capcos have proven to be unsuccessful for a variety of reasons. Such investments made by our capcos in small and new businesses we expected to and have had a high failure rate. As these problems become apparent and are dealt with, we attempt to terminate the businesses or transfer the assets so as to preserve maximum value. While losses from these ventures have been present, they have not been of such a magnitude as to have a material effect on our overall profitability. In 2005, we recorded $1 million of equity in earnings in one of our subsidiaries from an investment that was previously written off.

Certified Capital Companies

Overview. A capco is either a corporation or a limited liability company established in and chartered by one of the nine jurisdictions currently with authorizing legislation: Alabama, District of Columbia, Florida, Louisiana, Colorado, New York, Texas and Wisconsin. (Missouri has an older program which pre-dates the start of our business and in which we do not participate.) 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 equity or debt investments in companies. In some states, the law permits capco investments in majority-owned or primarily controlled companies. In others, such as Louisiana, Colorado, Texas and the most recent programs in New York, there are some limitations on the percentage of ownership a capco may acquire. In conjunction with the capcos investment in these companies, the capcos may also provide loans to the companies. In most cases, the tax credits provided by the states are equal to the par amount of investment by the insurance companies in the securities of the capcos, which can be utilized by them generally over a period of four to ten years, These credits are unaffected by the returns or lack of returns on investments made by the capcos.

The Role of Capcos in Our Business Strategy. We have determined that generally, the features of the capco programs facilitate our use of the capco funds in the support of our development as a holding company for a network of small business service providers. While observing all requirements of the capco programs and, in particular, financing qualified businesses meeting applicable state requirements as to limitations on the proportion of ownership of qualified businesses, we have been able to use this funding source as a means to facilitate the growth of our businesses, which are strategically focused on providing goods and services to small businesses such as those in which our capcos invest.

For example, the capco program in Louisiana precludes capcos from making controlling and majority- owned investments. Accordingly, investments made by the Louisiana capcos are considered portfolio companies and are majority-owned, operated and controlled by their boards of directors and management. These portfolio companies operate independently of Newtek although Newtek participates on the board of directors of these companies (but in all cases we do not control a majority of the board unless there is a default under the terms of the investment) and makes available to them technology, services and products to sell.

The authorizing statutes in all of the states in which our capcos operate explicitly allow and encourage the capcos to take minority equity interests, and in some cases majority or controlling interests, in companies. Consequently in all of the states we operate capcos, we may, consistent with our business objectives, acquire equity interests in companies through the use of the funds in the capcos and provide management and other services to these companies. The investments by the capcos create jobs and foster economic development consistent with the objectives of the programs as stated in most capco statutes. Furthermore, because our capcos have arranged for the repayment of a portion of the capco notes by The National Union Fire Insurance Company of Pittsburgh or The American

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International Specialty Lines Insurance Company, both affiliates of The American International Group, Inc., and a portion of the capco notes is paid through the delivery of tax credits, our capcos are under no pressure to generate short-term profits and may invest for long-term profitability. Due to the nature of the capco programs, we are able to accept the higher level of losses common to start up companies because we have the ability to devote the time, attention and resources to these companies which they require to become successful.

Because we use insurance to protect the principal of funds loaned to our capcos by insurance companies as well as the tax credits which they receive from us, and in light of the cost of such insurance, in all of the capcos we have organized, after payment of the organizational costs and the capco insurance premium, the remaining cash is equal to approximately 50% of the amount initially raised. An important feature of all capco programs is that a minimum of 50% of the initial investment in the capcos must be placed in qualified business investments within a specified time, usually four or five years. As each capco receives repayment of debt plus interest, as well as receives return of and on equity investments, it is able to reinvest the funds in other qualified businesses, which in some states may be its affiliated companies or others. It is through this investment-return-and-reinvestment process that our capcos are able to meet the minimum investment requirements of the capco programs. In 2003 our capcos received total repayments or returns of approximately $6.3 million, in 2004 they received approximately $12.6 million and in 2005 they received approximately $4.8 million. These funds supplemented the funds available for meeting minimum investment requirements. At December 31, 2005, 14 of our 16 operating or managed capcos had met their respective minimum 50% investment requirements. On a cumulative basis through December 2005, our capcos have received insurance company funds of $236 million. As of December 31, 2005, we were in full compliance with all of our capco funding requirements but have yet to invest $6 million in order to satisfy all minimum investment requirements.

The recognition of revenue by our capcos represents our largest single source of revenue, equal to approximately 38% of our gross revenue in 2005, 48% in 2004 and 74% in 2003. This trend demonstrates clearly the shift in our business from reliance on the capco funding to the development of operating businesses generating increasing amounts of revenues, income and cash flows.

We and our capcos do not generate any revenue for goods or services sold to the companies in which we invest. The companies in which the capcos invest do provide services, and to a much lesser degree goods, to each other. However, the effect of such inter-company revenues and expenses are eliminated in the consolidated financial statements. We rely on the annual management fees of 2.5% of certified (initial) capital, as fixed by the capco statutes, and profits from non capco operations as our principal source of cash to cover our operating expenses. This covers all supportive services generally provided by us, however, the management fee is paid out of capco cash on hand and is not set aside or reserved for payment out of the funds received by the capcos.

In order to make the capco investments successful, and thus to fulfill the public policy objectives of the capco programs, we have enhanced the capco funding mechanism by offering management resources, technical, operational and professional expertise and non-capco funds to the investee companies. Depending on the state capco program and to the extent permitted by state law and regulation, the services can range from advice and assistance with strategic relationships to direct and daily involvement in policy making and management. For example, in the state of Louisiana the capco is precluded from controlling the policy making, management and operations of the investee company and accordingly the capcos only participate in the policy making of the company by exercising their rights under the terms of the investment.

Tax Credits. In return for the capcos making investments in the targeted companies, the states provide tax credits, generally equal to funds invested in the capco by the insurance companies, that are available for use by insurance companies that provide the funds to the capcos. In order to maintain its

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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. The final loss of capco status (i.e., decertification as a capco) could result in loss or possible recapture of the tax credit. To protect against such losses, our 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, they must meet certain investment requirements, both qualitative and quantitative.

Quantitative Requirements: These include minimum investment amounts and time periods for investment of certified capital (the amount of the original funding of the capco by the insurance companies). For example in the state of New York, a capco must invest at least 25% of its certified capital 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: Management s Discussion and Analysis - Income from Tax Credits and Note 1 to the Consolidated Financial Statements - Revenue Recognition. The minimum requirements are calculated on a cumulative basis and allow the capcos to receive a return of an investment and re-invest the funds for full additional credit towards the minimum requirements.

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 our business is the fact that most of 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 (the state of Louisiana precludes the capco from taking controlling and majority ownership positions in investee companies). This enables us 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 our own objectives of developing a number of small business service companies which may become profitable and return a meaningful return both to our shareholders and to the local participants in the businesses. In addition, because the businesses that we invest in 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.

Investment Limitations: The states of Louisiana, Colorado, Texas and in the two most recent programs in New York (out of the 5 we have participated in) have had or recently added to their capco programs limitations on the equity investment capcos can make in qualified businesses. These programs or program changes seek to preclude a capco from owning all or a majority of the voting equity of the invested business. While Newtek has in the past made use of the ability to make profitable majority-owned investments, we have also made minority or more passive investments in qualified businesses. Newtek s capcos are in full compliance with these types of investment limitations and management foresees no significant difficulty in continuing to do so.

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

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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 our capcos would have a material adverse effect on our business 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. Compliance with these requirements is reflected in contractual provisions of the agreements between each capco and its investors. The capcos covenant to their investors to use the funds only for investments as permitted by the capco laws or for related expenses and to refrain from taking any action which would cause the capco to fail to continue in good standing.

Compliance: As of the end of 2005, all of our capcos were in compliance with all applicable requirements and 14 of the 16 operational/managed capcos had met their final, minimum 50% investment thresholds. This eliminates any material risk of decertification and tax credit recapture or loss for its insurance company investors in these capcos. This represents $206 million of tax credits, or about 95% of the tax credits associated with all of our capcos. See the discussion of capco investment requirements and capco cash in the Notes to Financial Statements.

Insurance. The capco notes require, as a condition precedent to the funding of the notes, that insurance be purchased to cover the risks associated with the operation of its capcos. This insurance is purchased from American International Specialty Lines Insurance Company and National Union Fire Insurance Company of Pittsburgh, both subsidiaries of American International Group, Inc., (AIG) an international insurer. In order to comply with this condition to the funding, the closing on the capco notes are structured as follows: (1) the investors wire the cash proceeds from the notes issuance directly into an escrow account (2) the escrow agent, pursuant to the requirements under the notes and escrow agreement, automatically and simultaneously funds the purchase of the capco insurance from the proceeds received. We are not entitled to the use and benefit of the net proceeds received until the escrow agent has completed the purchase of the insurance. AIG and its subsidiaries noted above are AA+ rated by Standard & Poor s. Under the terms of this insurance, which is for the benefit of the investors, the capco insurer incurs the primary obligation to repay the investors a substantial portion of the debt as well as to make compensatory payments in the event of a loss of the availability of the related tax credits. In the event of either a threat of or a 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 payments in lieu of forfeited or recaptured tax credits. However, control by the capco 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 our ability to obtain certification for capcos in additional states as new legislation makes other opportunities available. The capcos are individually insured, and the assets of one are not at risk for the obligations of the others. AIG itself has not agreed to guarantee the obligations of its subsidiary insurers but has agreed to transfer the obligations to another of its subsidiaries if the insurers are down-rated.

Competition

Our business now requires that we compete at two basic levels. First**,** 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. Our management believes it has been successful in raising funds because of:

- the manner in which we have structured the participation by the insurance companies, including our issuance of shares as an equity bonus to investors who buy our capco notes;

- the insurance which we have been able to obtain to cover any loss of the tax credits and

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the obligation to repay principal, resulting in a credit rating for the instruments of AA+;

the previous business experience of our principals;

the national marketing of our programs; and

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

Second**,** and more importantly, we and our operating businesses must also compete in a number of markets for the sale of services to other businesses. We have narrowed the focus of principal investments to that of six principal operating lines. Each of these requires our 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 our companies compete are dominated by a small number of companies which could materially affect the nature or terms of the competition. In addition, in many cases, the competitors which our companies face are not as able as our companies to take advantage of changes in business practices due to technological developments and, for those with a larger size, are unable to offer the personalized service that many small business owners and operators seem to want.

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The following chart describes the role of capcos in our business:

[1] We have invested $6 million in seed capital to establish 12 capcos (and 3 funds) through December 2005.

[2] Our capcos (in conjunction with our capco insurer) have raised approximately $236 million from insurance company investors through December 2005.

[3] $118 million invested in businesses through December 31, 2005.

[4] $73 million actually invested in such companies through December 31, 2005. Newtek s capcos are precluded under various state statutes (including in Louisiana and under certain circumstances Colorado and the most recent program in New York) from taking majority and controlling interests in investee companies. In these circumstances, our capcos make non-controlling minority investments in portfolio companies.

[5] A smaller portion of investments are venture capital-type or passive investments, both debt and equity.

[6] Our non-capco revenue increased over 64% from 2004 to 2005 and increased 52% to 63% of total revenue.

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Execution: Greater Emphasis on Centralized Management

We previously implemented our strategy through decentralized management with an emphasis on Regional Business Development Centers. During 2005 we determined to shift this emphasis in order to improve consistency in management, in financial and personnel supervision, in coordination among the principal product lines and in improved profitability. We still maintain offices in each of the capco jurisdictions and also maintain our relationships with the co-participants in the capcos and the entrepreneurs operating our investee companies. The difference is that we place greater reliance on management based in our New York City office without detracting from the important functions which can only be provided by a local presence. We have therefore, discontinued the use of the concept of regional business development centers and focus attention on the development of each business and its unique needs and strengths. We believe that the management resources available to the company in its headquarters office are sufficient to fulfill our currently expected needs. Since determining to place greater emphasis on centralized management, we have terminated our relationships with a number of the previous regional managers and continue to be associated with only the following, of which neither Mr. Schottenstein nor Mr. Ash receive any compensation for their duties as managers. The company owned by Mr. Harris and Mr. Sellers received a total of $28,000 in fees from the Company in 2005.

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 acquired Bell Supply Company (retail oil and gas equipment supply company based in Kilgore, Texas) and Omni Exploration Company. Mr. Schottenstein also serves on the Board of Directors of Newtek.

Douglas Sellers, Alabama - Mr. Sellers is currently an executive Vice President of Merchant Capital, LLC and a member of the Board of Directors of Merchant Capital Investments, Inc. Merchant Capital, LLC is a merchant and investment banking firm founded in 1987. Merchant Capital has become one of the leading investment banking firms in the State of Alabama as well as the Southeast. Merchant Capital Investments, Inc., the parent of Merchant Capital, LLC, is a diversified holding company which interests include, or have included, investments in manufacturing entities, real estate developments, assisted living facilities, multi-family residential developments, wireless cable television company, cellular telephone companies and other assorted investments.

Over the last 15 years, Mr. Sellers has invested in over ten separate entities. All of these funds were on behalf of accredited investors. His responsibility for these investments has included board memberships and other day-to-day activities of some of these investments. Merchant Capital has participated in raising or investing equity capital in excess of $45 million for these related businesses, and through the use of additional debt financing the total asset costs for these businesses exceeds $160 million.

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Thomas Harris, Alabama - Mr. Harris has extensive experience making venture capital investments in small businesses. He is a member of the Executive Committee of the Alabama capco as well as of the Board of Directors of Merchant Capital Investments, Inc. (MCI), which owns a minority (less than 1 percent), interest in the capco. Since its founding, MCI has invested, primarily on behalf of its shareholders, in many types of companies. MCI, through its affiliated companies, partnerships and investments in 2003 will employ over 700 people and has ownership, wholly or as a major partner, in existing and/or proposed projects representing a total investment exceeding $60 million.

Matthew Ash, District of Columbia - Mr. Ash is of counsel with the law firm of Cozen O Connor and has over thirty years of experience both as counsel to and investor and principal in numerous small and medium-sized businesses. Mr. Ash has provided legal services to us and all of our capcos since 1998. Mr. Ash is a manager of our DC capco and provides direct assistance to our investment and business development efforts in the District.

Regional managers are required to 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 these services are the services provided by us 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 affiliated companies are able to benefit from the availability of their experiences, knowledge, contacts, resources and skills. Affiliated companies and other investees who receive these services do not generally pay anything for them as they are provided by us to ensure the success of its acquisitions and investments. However, when a company within our network purchases services from another affiliated company, it pays the fair value for those services but because of inter-company elimination, there is no impact on our consolidated financial position or results of operations.

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 our 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 us in our newer initiatives in non-capco areas.

Government Regulation; Investment Company Act of 1940

Overview. Because of the nature of our business, our management 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 us would impose requirements and limitations that are materially inconsistent with our current and intended business strategy. However, with our increased 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 to the public as such or by

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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.

Our business strategy and business activities focus upon taking majority-ownership and primary controlling interests in affiliated companies with a view to participating actively in their management and development. We believe that this strategy and the scope of our business activities would not cause us to fall within the definition of an investment company or, if so, provide us with a basis for an exclusion from the definition of an investment company under the Investment Company Act.

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, 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 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 we operate 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 require a reporting company s chief executive and chief financial officers to certify certain financial and other information included in our 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 our disclosure controls and procedures; that they have made certain disclosures to the auditors and to the audit committee of the board of directors about our 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. Under rules currently in effect, Newtek is not yet subject to all of the requirements for the development of internal controls; we expect this to become applicable to us in 2007 pending changes currently under consideration by the Securities Exchange Commission (See Section 9A for managements current assessment of related control matters).

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-K. The certifications required by Section 906 of the Sarbanes-Oxley Act also accompany this Form 10-K.

Intellectual Property

Newtek has developed software which is the core of its referral system. This software is not as yet subject to patent protection but the company is pursuing the matter and plans to seek protection in the near future but there can be no assurance that the final result will protect the Company against any challenges or misappropriations.

CrystalTech Web Hosting, Inc. uses software developed by its former owner, Mr. Uzzanti, which is critical to the conduct of its business as currently structured. Perpetual zero cost rights to this software were obtained by CrystalTech at the time of the acquisition of the business from Mr. Uzzanti.

Newtek has not attempted to trademark its name due to likelihood that it would be unable to obtain adequate protection due to the common use of the term.

Employees

As of December 31, 2005, we and the companies in which we hold a controlling interest had approximately 360 employees, independent representatives and contract employees. We believe our labor relations are good and none of its employees are covered by a collective bargaining agreement. All of our employees with access to customer or sensitive information and, where appropriate consultants, have executed confidentialty agreements and it is our policy to require all new employees to do so as well.

Item 1A Risk Factors

If any of the following risks occur, our business, financial condition and results of operations could be materially and adversely affected. In that case, the value of our common shares could decline and you may lose all or part of your investment. The risks set out below are not the only risks we face.

RISKS RELATING TO OUR BUSINESS GENERALLY

Our business focuses on the investment in and acquisition of small businesses, which typically have a high rate of failure, may take some time to become profitable and may never become profitable.

We place primary emphasis on the investment in and acquisition of small businesses with the objective of developing a network of profitable businesses, most of which will principally serve the small and medium-sized business market. Early stage businesses historically have a higher rate of failure than larger businesses, and many that do not fail will have only limited profitability. Moreover, profit generated by any of our majority-owned companies or other investments could be offset by losses generated by others. Our profitability resulting from the operations of our businesses may be delayed for the foreseeable future.

We have generated and carry goodwill as an asset resulting from some of our acquisition transactions. In 2005, we determined to write down the value of our goodwill by approximately $878,000, and in 2003, management wrote down the value of our goodwill by approximately $1,435,000. We can make no assurance that our current or future additional goodwill will not be written down pursuant to applicable accounting standards. A significant write down of a major asset, such as goodwill, could have a material adverse effect on our business, a negative impact on earnings and the value of our common shares.

Each of our major investments and affiliated companies may be impacted by a variety of adverse economic, governmental, industrial and internal company factors unique to that business and outside our control. If our investments and affiliated companies do not succeed in overcoming these adverse factors, the value of our assets and the price of our shares would fall.

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In the past few years we have increasingly concentrated our investments in companies participating in small business lending, electronic payment processing, the Newtek Insurance Agency and CrystalTech. Each of these businesses has numerous risks associated with them and you should read the specific risk factors set forth below with respect to each of these businesses.

As we have concentrated our investments, typically made through the capco programs, in companies which are part of our nationwide marketing strategy of providing a variety of services to small and medium-sized businesses, our exposure and that of our affiliated companies to risks specific to these business lines has increased. We discuss below some of the risks of our significant operations in government-guaranteed small business lending, acting as an independent sales organization in the electronic card processing business, web hosting business and operating as an insurance agency. If we are not successful in implementing this business strategy and developing and marketing our new products and services, our results of operations will be negatively impacted.

If we do not manage our growth effectively, our financial performance could be harmed.

Our rapid revenue growth has placed, and will continue to place, certain pressures on our management, administrative, operational and financial infrastructure. As we continue to grow our business, such growth could require capital, systems development and human resources beyond current capacities. As evidence of our internal growth, on December 31, 2001, we and all of our consolidated and majority-owned affiliates had approximately 20 employees, and on December 31, 2005 we had approximately 360 employees and independent contractors. The increase in the size of our operations may make it more difficult for us to ensure that we execute our present businesses and future strategies. The failure to manage our growth effectively could have a material adverse effect on our financial condition, results of operations and cash flows.

If we are unable to obtain the resources required for the growth and development of our affiliated companies, they will be highly susceptible to failure, which would directly affect our profitability and value.

Early-stage businesses often fail due to their limited capital and human resources. The effective implementation of our business model is dependent upon the ability of the affiliated companies, with assistance from us, to arrange for the managerial, capital and other resources which they usually require in order to become and remain profitable.

We may not be able to integrate acquired companies into our company and, as we acquire more and larger interests in affiliated companies, our resources available to assist our affiliated companies may be insufficient.

We have made strategic acquisitions and we intend to continue to make acquisitions in accordance with our business plan. Each acquisition involves a number of risks, including:

- the diversion of our management s attention to the assimilation and ongoing assistance with the operations and personnel of the acquired business, which could strain the management resources we have available;
- the potential for our affiliated companies to grow rapidly and adversely affect our ability to assist our affiliated companies as intended;
- possible adverse effects on our results of operations and cash flows; and
- possible inability by us to achieve the intended objective of the acquisition.

Any strain on our ability to assist our affiliated companies as intended or to acquire and integrate businesses under our business plan could have a negative impact on our operations, financial results and cash flows.

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Our business may be adversely affected by the highly regulated industries in which we operate.

Many of the industries in which we operate are highly regulated and we cannot assure you that we or our affiliated companies are, or that we will continue to be, in full compliance with current laws, rules and regulations. If we or our affiliated companies are unable to comply with applicable laws or regulations or if new laws limit or eliminate some of the benefits of our business lines, our financial condition, results of operations and our cash flows could be materially adversely affected.

If we lose our key personnel, we may not be able to find and hire experienced replacements.

Our business relies heavily on the expertise of our senior management, particularly Messrs. Barry Sloane, Michael J. Holden and Jeffrey G. Rubin, our CEO, CFO and President, respectively. Messrs. Sloane and Rubin currently serve pursuant to employment agreements which expire on June 30, 2006. The loss of the services of these individuals could have a material adverse effect on our financial condition, results of operations and cash flows and it is likely that it will be difficult to find adequate replacements.

Our method of income recognition derived from the capco tax credits causes most of such income to be received in the first five years of the programs. In the absence of income from our investments or other sources, we would sustain material losses in later years.

In our capco programs we recognize the majority of our income from the tax credits in the early years of the programs because income recognition is tied to the schedule by which the tax credits become irrevocable and beyond recapture (approximately five years). We recognize the majority of our income from an average ten year capco programs in the first five years and will not be recognizing significant tax credit income in the latter part of the program. However, we will continue to incur costs for the administration of the capcos and (non-cash) interest expenses on the capco notes. In the absence of income from other sources, such as our investments in small businesses and affiliated companies, our income would decrease materially and we would likely sustain material losses in the later years of the programs and in particular in 2006 and 2007.

We currently rely solely on common law to protect certain but not all of our intellectual property; should we seek additional protection in the future, we may be unable to register successfully certain trademarks, possibly causing us to lose our rights to such trademarks.

While certain of our intellectual property and trademarks are registered all are not. We do not rely on these marks at present in our marketing efforts but if we should in the future and if we should attempt to register them we may be unable to protect the rights and potentially lose the rights to the marks.

Our affiliated companies depend upon the ability to utilize the Internet for the conduct of a significant portion of their business; disruption to that system could make it impossible for them to continue to conduct their current businesses.

Possible disruption to the normal functioning of the Internet through, for example, power failure or terrorist sabotage, could make it impossible for aspects of the lending, electronic payment processing, web hosting and in fact our referral system to function. Each of our businesses have addressed the possibilities of short term disruptions and planned accordingly. However, in the event of a major disruption, and assuming that the disruptions would be long lived, we would be required to make extensive changes in the way these companies do business. There is assurance that we will have the time and resources to make these changes.

We and our affiliated companies depend on our ability to attract and retain key personnel and any loss of ability to attract these personnel could adversely affect us.

Our success depends upon the ability of our affiliated companies and other investments to attract and retain qualified personnel and our ability to supplement those capabilities with our senior management personnel. Competition for qualified employees is intense. If our affiliated companies lose the services of key personnel, or are unable to attract additional qualified personnel, the business, financial condition, results of operations and cash flows of us or one or more of our affiliated companies could be materially adversely affected. It can take a significant period of time to identify and hire personnel with the combination of skills and attributes required in carrying out our strategy.

Our success depends on our ability to compete effectively in the highly competitive industries in which we operate.

We face intense competition in organizing capcos, originating SBA loans, processing electronic payments and offering insurance, as well as in the other industries in which we or our affiliated companies operate. Low barriers to entry often result in a steady stream of new competitors entering certain of these businesses. Current and potential competitors are or may be better established, substantially larger and have more capital and other resources than we do. If we expand into additional geographical markets, we will face competition from others in those markets as well.

Our success also depends on our ability to use effectively our electronic referral and processing system.

We have developed and are placing in operation an electronic referral and processing system for the applications necessary for the sales of each of our business lines other than web site hosting. This system is critical to our ability to process such business with a low cost advantage and to obtain referrals from our alliance partners. In particular, their ability to access the referral system and to track the progress of a referred customer is a major feature of the perceived attractiveness of our system. If this referral system should develop problems which we cannot address, it would have a material negative impact on our business strategy.

A major feature of our business strategy is the development of opportunities for our service and product provider businesses to market to the customers of our other business lines and to the customer bases of our alliance partners.

Although our business strategy contemplates the referral of prospects between wholly-owned and partially owned companies in our network, there is no history of such cross-selling and there can be no assurances that any effort to make referrals across our network of affiliated companies will result in additional revenue opportunities. In order for our referral network to achieve the desired result, each of the constituent companies must have proper incentives and feel comfortable making such introduction, and furthermore, the service provider receiving such referral must properly service such referred client. Instituting a corporate culture conducive to sending and receiving referrals is difficult and may not yield the results anticipated by us. In addition, our marketing alliances are terminable and, if we make serious errors or fail to produce sufficient revenues for our alliance partners, we are at risk of losing these relationships.

The inability of any one of our business segments to service customers adequately referred to it from within our other companies could impair our overall relationship with such customers.

A significant benefit of our structure and strategy is the ability to cross market between our SBA, electronic payment processing and other business customers, including potentially those of CrystalTech. However, should the business relationship between one of our business segments and customers deteriorate for any reason, such customers may opt to withdraw their business from our other businesses. Such a loss of business could negatively impact our results of operations and cash flows.

We rely on information processing systems, and our strategy of cross marketing to customers among our majority-owned subsidiaries will increase this reliance; the interruption, loss or failure of which would materially and adversely affect our business.

Our ability to provide business services depends, and will increasingly depend, on our capacity to store, retrieve, process and manage significant amounts of data and expand and upgrade our information processing capabilities. Interruption or loss of our information processing capabilities through loss of stored data, breakdown or malfunctioning of computer equipment and software systems, telecommunications failure or damage caused by acts of god or other disruption, could have a material adverse effect on our business, financial condition, results of operations and cash flows. Although we have disaster recovery procedures in place and insurance to protect against such contingencies, we cannot be certain that our disaster recovery systems or insurance will continue to be available at reasonable prices, cover all our losses or compensate us for the possible loss of clients occurring during any period that we are unable to provide outsourced business services.

We are attempting to build a national Newtek brand for services and products marketed to small and medium-sized businesses, but we are unable to obtain a significantly high level of protection for the brand name due to its previous usage in other contexts.

The current and past usage by others of names similar to Newtek may make obtaining a significant level of protection for the use of such name very costly. We cannot assure you that we will be able to prevent competitors from using the name Newtek in other contexts or even in competition with us. In the event of such an infringement, we would attempt to vigorously defend our rights to the name, but we can give no assurance that we will be successful in doing so. We have not registered the mark Newtek with the United States Patent and Trademark Office.

RISKS RELATING TO OUR SBA LENDING BUSINESS

We may be adversely affected by the regulated environment in which we operate.

The activities of our SBA lending business are subject to the supervision and regulation by the federal government and to a lesser degree the state governments, as well as various laws and judicial and administrative decisions. Our possible inability to remain in compliance with these multiple requirements could result in the revocation or suspension of our license or the imposition of fines and penalties.

We have specific risks associated with small business administration loans.

We have generally sold the guaranteed portion of SBA loans in the secondary market. There can be no assurance that we will be able to continue originating these loans, or that a secondary market will exist for, or that we will continue to realize premiums upon the sale of, the guaranteed portions of the SBA loans.

We believe that our SBA loan portfolio does not involve more than a normal risk of collection. However, since we sell the guaranteed portion of substantially all of our SBA loan portfolio, we incur credit risk on the non-guaranteed portion of the SBA loans. We share pro rata with the SBA in any recoveries. In the event of default on an SBA loan, our pursuit of remedies against a borrower is subject to SBA approval, and where the SBA establishes that its loss is attributable to deficiencies in the manner in which the loan application has been prepared and submitted, the SBA may decline to honor its guarantee with respect to our SBA loans or it may seek the recovery of damages from us. If we should experience significant problems with our underwriting of SBA loans, such failure to honor a guarantee or the cost to correct the problems could have a material adverse effect on us. Although the SBA has never declined to honor its guarantees with respect to SBA loans made by us since our acquisition of the lender, no assurance can be given that the SBA would not attempt to do so in the future.

Curtailment of the government guaranteed loan programs could cut off an important segment of our business.

There can be no assurance that the federal government will maintain the SBA program, or that it will continue to guarantee loans at current levels. If we cannot continue making and selling government guaranteed loans, we will generate fewer origination fees and our ability to generate gains on sale of loans will decrease. From time to time, the government agencies that guarantee these loans reach their internal budgeted limits and cease to guarantee loans for a stated time period. In addition, these agencies may change their rules for loans. Also, Congress may adopt legislation that would have the effect of discontinuing or changing the programs. Non-governmental programs could replace government programs for some borrowers, but the terms might not be equally acceptable. If these changes occur, the volume of loans to small business and industrial borrowers of the types that now qualify for government guaranteed loans could decline, as could the profitability of these loans.

Changing interest rates may reduce our income from lending.

Fluctuations in general economic conditions and in interest rates may affect customer demand for our loans and other products and services as well as the performance of our existing portfolio. Our lending business may increase during times of falling interest rates and, conversely, decrease during times of significantly higher interest rates. Significant fluctuations in interest rates and loan demand could have a potentially adverse effect on our results of operations and cash flows.

An increase in non-performing assets would reduce our income and increase our expenses.

If our level of non-performing assets in our SBA lending business rises in the future, it could adversely affect our revenue and earnings. Non-performing assets are primarily loans on which borrowers are not making their required payments. Non-performing assets also include loans that have been restructured to permit the borrower to have smaller payments and real estate that has been acquired through foreclosure of unpaid loans. To the extent that our loan assets are non-performing, we will have less cash available for lending and other activities.

Our reserve for credit losses may not be sufficient to cover unexpected losses.

Our business depends on the behavior of our customers. We believe that our credit underwriting procedures are sufficient to protect us against all but the most unexpected events. In addition to our credit practices and procedures we maintain a reserve for credit losses on our SBA loans which management has judged to be adequate given the loans we make. We periodically review our reserve for adequacy considering current economic conditions and trends, collateral values, charge-off experience, levels of past due loans and non-performing assets and adjust our reserve accordingly. However, based on the increased volume in recent originated loans, along with changes in the credit quality of our customers, our reserves could materially be impacted thus affecting our financial condition and results of operations.

We compete with numerous financing sources.

We compete for our customers primarily on the basis of pricing, terms and service. Competition from both traditional lenders and new entrants is intense due to the recent strong economy and the ease with which the securitization process has increased the access to capital. While we have attempted to utilize our referral system as a means of obtaining customers at a low cost and processing the applications efficiently, there can be no assurance that we will be able to match the terms of our competitors without incurring losses. In addition, due to our relatively small size and capitalization, our larger competitors may be able to make loans when we are not due to our dependence on external warehouse financing.

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RISKS RELATING TO OUR ELECTRONIC PAYMENT PROCESSING BUSINESS

We rely currently on a single bank sponsor, which has substantial discretion with respect to certain elements of our business practices, in order to process bankcard transactions. If this sponsorship is terminated and we are not able to secure or migrate merchant portfolios to new bank sponsors, we will not be able to conduct our electronic payment processing business.

Because we are not a bank, we are unable to belong to and directly access the Visa and MasterCard bankcard associations. The Visa and MasterCard operating regulations require us to be sponsored by a bank in order to process bankcard transactions. We are currently registered with Visa and MasterCard through the sponsorship of one bank that is a member of the card associations. If this sponsorship is terminated and we are unable to secure a bank sponsor, we will not be able to process bankcard transactions. Furthermore, our agreement with our sponsoring bank gives the sponsoring bank substantial discretion in approving certain elements of our business practices, including our solicitation, application and qualification procedures for merchants, the terms of our agreements with merchants, the processing fees that we charge, our customer service levels and our use of independent sales organizations. We cannot guarantee that our sponsoring bank s actions under these agreements will not be detrimental to us.

If we or our processors or bank sponsor fail to adhere to the standards of the Visa and MasterCard bankcard associations, our registrations with these associations could be terminated and we could be required to stop providing payment processing services for Visa and MasterCard.

Substantially all of the transactions we process involve Visa or MasterCard. If we, our bank sponsor or our processors fail to comply with the applicable requirements of the Visa and MasterCard bankcard associations, Visa or MasterCard could suspend or terminate our registration. The termination of our registration or any changes in the Visa or MasterCard rules that would impair our registration could require us to stop providing payment processing services, which would have a material adverse effect on our business.

We and our electronic payment processing subsidiaries rely on other card payment processors and service providers. If they no longer agree, or are unable, to provide their services, our merchant relationships could be adversely affected and we could lose business.

Our electronic payment processing business relies on agreements with several other large payment processing organizations to enable us to provide card authorization, data capture, settlement and merchant accounting services and access to various reporting tools for the merchants we serve. We also rely on third parties to whom we outsource specific services, such as reorganizing and accumulating daily transaction data on a merchant-by-merchant and card issuer-by-card issuer basis and forwarding the accumulated data to the relevant bankcard associations. Many of these organizations and service providers are our competitors. The termination by our service providers of these arrangements with us or their failure to perform these services efficiently and effectively may adversely affect our relationships with the merchants whose accounts we serve and may cause those merchants to terminate their processing agreements with us.

On occasion, we experience increases in interchange and sponsorship fees. If we cannot pass these increases along to our merchants, our profit margins will be reduced.

Our electronic payment processing subsidiaries pay interchange fees or assessments to bankcard associations for each transaction we process using their credit, debit and gift cards. From time to time, the bankcard associations increase the interchange fees that they charge processors and the sponsoring banks. At their sole discretion, our sponsoring banks have the right to pass any increases in interchange fees on to us. In addition, our sponsoring banks may increase their Visa and MasterCard sponsorship fees, all of which are based upon the dollar amount of the payment transactions we process. If we are not able to pass these fee increases along to merchants through corresponding increases in our processing fees, our profit margins in this line of business will be reduced.

Unauthorized disclosure of merchant or cardholder data, whether through breach of our computer systems or otherwise, could expose us to liability and business losses.

Through our electronic payment processing subsidiaries, we collect and store sensitive data about merchants and cardholders and we maintain a database of cardholder data relating to specific transactions, including payment, card numbers and cardholder addresses, in order to process the transactions and for fraud prevention and other internal processes. If anyone penetrates our network security or otherwise misappropriates sensitive merchant or cardholder data, we could be subject to liability or business interruption. We cannot guarantee that our systems will not be penetrated in the future. If a breach of our system occurs, we may be subject to liability, including claims for unauthorized purchases with misappropriated card information, impersonation or other similar fraud claims. Similar risks exist with regard to the storage and transmission of such data by our processors.

We have potential liability if our merchants refuse or cannot reimburse charge-backs resolved in favor of their customers.

If a billing dispute between a merchant and a cardholder is not ultimately resolved in favor of the merchant, the disputed transaction is charged back to the merchant s bank and credited to the account of the cardholder. If we or our processing banks are unable to collect the charge-back from the merchant s account, or if the merchant refuses or is financially unable due to bankruptcy or other reasons to reimburse the merchant s bank for the charge-back, we bear the loss for the amount of the refund paid to the cardholder s bank.

We face potential liability for customer or merchant fraud.

Credit card fraud occurs when a merchant s customer uses a stolen card (or a stolen card number in a card-not-present transaction) to purchase merchandise or services. In a traditional card-present transaction, if the merchant swipes the card, receives authorization for the transaction from the card issuing bank and verifies the signature on the back of the card against the paper receipt signed by the customer, the card issuing bank remains liable for any loss. In a fraudulent card-not-present transaction, even if the merchant receives authorization for the transaction, the merchant is liable for any loss arising from the transaction. Many of our business customers are small and transact a substantial percentage of their sales over the Internet or by telephone or mail orders. Because their sales are card-not-present transactions, these merchants are more vulnerable to customer fraud than larger merchants and we could experience charge-backs arising from cardholder fraud more frequently with these merchants.

Merchant fraud occurs when a merchant, rather than a customer, knowingly uses a stolen or counterfeit card or card number to record a false sales transaction or intentionally fails to deliver the merchandise or services sold in an otherwise valid transaction. Anytime a merchant is unable to satisfy a charge-back, we are responsible for that charge-back. We have established systems and procedures to detect and reduce the impact of merchant fraud, but we cannot assure you that these measures are or will be effective. Failure to manage effectively risk and prevent fraud could increase our charge-back liability.

Our payment processing systems may fail due to factors beyond our control, which could interrupt our business or cause us to lose business and likely increase our costs.

We depend on the uninterrupted operations of our computer network systems, software and our processors data centers. Defects in these systems or damage to them due to factors beyond our control, and notwithstanding any redundant systems we develop and implement, could cause severe disruption to our business and other material adverse effects on our payment processing businesses.

RISKS RELATING TO OUR OPERATION OF A WEBSITE HOSTING BUSINESS

CrystalTech operates in a competitive industry where technological change can be rapid.

The website hosting business and its related technology involve a broad range of rapidly changing technologies. CrystalTech s equipment and the technologies on which it is based may not remain competitive over time, and others may develop superior technologies that render CrystalTech s products non-competitive without significant additional capital expenditures.

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CrystalTech s website hosting business depends on the efficient and uninterrupted operation of its computer and communications hardware systems and infrastructure.

Despite precautions taken by CrystalTech against possible failure of its systems, interruptions could result from natural disasters, power loss, the inability to acquire fuel for our backup generators, telecommunications failure, terrorist attacks and similar events. CrystalTech also leases telecommunications lines from local, regional and national carriers whose service may be interrupted. CrystalTech s business, financial condition and results of operations could be harmed by any damage or failure that interrupts or delays our operations and cash flows.

Of primary importance to CrystalTech s website hosting customers is the integrity of its infrastructure and the privacy of confidential information.

CrystalTech s infrastructure is potentially vulnerable to physical or electronic break-ins, viruses or similar problems. If a person circumvents CrystalTech s security measures, he or she could jeopardize the security of confidential information stored on CrystalTech s systems, misappropriate proprietary information or cause interruptions in CrystalTech s operations. We may be required to make significant additional investments and efforts to protect against or remedy security breaches. Security breaches that result in access to confidential information could damage our reputation and expose us to a risk of loss or liability. The security services that CrystalTech offers in connection with customers networks cannot assure complete protection from computer viruses, break-ins and other disruptive problems. Although CrystalTech attempts to limit contractually its liability in such instances, the occurrence of these problems may result in claims against CrystalTech or us or liability on our part. These claims, regardless of their ultimate outcome, could result in costly litigation and could harm our business and reputation and impair CrystalTech s ability to attract and retain customers.

CrystalTech s business depends on Microsoft Corporation and others for the licenses to use software as well as other intellectual property in the website hosting business.

CrystalTech s website hosting business is built on a technological platform relying on the Microsoft Windows® products and other intellectual property that CrystalTech currently licenses. As a result, if we are unable to continue to have the benefit of those licensing arrangements or if the products upon which CrystalTech s platform is built become obsolete, our business could be materially and adversely affected.

CrystalTech depends on the services of a few key personnel in managing its website hosting business, and the loss of one or more of them could materially impair its ability to maintain current levels of customer service and the proper technical operations of its business.

We depend upon the continued management by Tim Uzzanti of the operations of CrystalTech s website hosting business, along with three or four other individuals to supervise CrystalTech s technical operations and the customer technical service response. If we were to lose the services of one or more of these persons and were unable to replace them expeditiously, our website hosting business could be significantly diminished.

RISKS RELATING TO OUR INSURANCE AGENCY BUSINESS

We cannot assure that the insurance services we plan to offer will be price competitive or accepted by our customers.

Despite our efforts to design, market and deliver integrated services to our customers, our proposed new services may not be widely accepted and we may not be able to compete with other larger and better capitalized providers of such services.

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We depend on third parties, particularly property and casualty insurance companies, to supply the products marketed by our agents.

Our contracts with property and casualty insurance companies typically provide that the contracts can be terminated by the supplier without cause. Our inability to enter into satisfactory arrangements with these suppliers or the loss of these relationships for any reason would adversely affect the results of our new insurance business.

Termination of our professional liability insurance policy may adversely impact our financial prospects and our ability to continue our relationships with insurance companies.

We must maintain professional liability insurance in connection with the operation of this business. If we lose this insurance, it is unlikely that our relationships with insurance companies would continue.

If we fail to comply with government regulations, our insurance agency business could be adversely affected.

Our insurance agency business is subject to comprehensive regulation in the various states in which we plan to conduct business. Our success will depend in part upon our ability to satisfy these regulations and to obtain and maintain all required licenses and permits. Our failure to comply with any statutes and regulations could have a material adverse effect on us. Furthermore, the adoption of additional statutes and regulations, changes in the interpretation and enforcement of current statutes and regulations or the expansion of our business into jurisdictions that have adopted more stringent regulatory requirements than those in which we currently conduct business could have a material adverse effect on us.

We do not have any control over the commissions our insurance agency expects to earn on the sale of insurance products which are based on premiums and commission rates set by insurers and the conditions prevalent in the insurance market.

Our insurance agency earns commissions on the sale of insurance products. Commission rates and premiums can change based on the prevailing economic and competitive factors that affect insurance underwriters. In addition, the insurance industry has been characterized by periods of intense price competition due to excessive underwriting capacity and periods of favorable premium levels due to shortages of capacity. We cannot predict the timing or extent of future changes in commission rates or premiums or the effect any of these changes will have on the operations of our insurance agency.

RISKS RELATED TO OUR CAPCO BUSINESS

Because our capcos are subject to minimum investment and other requirements under state law, a failure of any of them to meet these requirements could subject the capco and our shareholders to the loss of one or more capcos and would preclude participation in future capco programs.

Involuntary decertification of all or substantially all of our capcos would result in material loss to us and our shareholders. In general, capcos issue debt and equity instruments, such as warrants, 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 maintain capco certification is that a capco must comply with minimum investment schedules that benchmark both the timing and type of required investments. Although to date we have met all applicable benchmarks, we may not do so in the future. A final involuntary loss of capco status, referred to as a decertification as a capco, will result in a loss of the tax credits for us and our insurance company investors; it would also enable the capco insurer, which

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has the obligation to make compensatory payments to offset the lost tax credits, to take control of one or more capcos and manage or liquidate the capco investments to offset its losses. This would deprive us of the value of the investments and make participation in future capco programs highly unlikely.

The capco programs and the tax credits they provide are created by state legislation, and such laws are subject to possible action to repeal or retroactively revise the programs for political, economic or other reasons. Such an attempted repeal or revision would create substantial difficulty for the capco programs and could, if ultimately successful, cause us material financial harm.

The tax credits associated with the capco programs and provided to our capcos investors are to be utilized by the investors over a period of time, typically ten years. Much can change during such a period and it is possible that one or more states may revise or eliminate the tax credits. Any such revision or repeal could have a material adverse economic impact on our capco, either directly or as a result of the capco s insurer s actions. During 2002 a single legislator in Louisiana did introduce such a proposed bill, on which no action was taken, and in Colorado in 2003 and 2004 bills to modify (not repeal) its capco program were introduced; the 2003 Colorado legislation was defeated in a legislative committee. The 2004 Colorado legislation was adopted and we have filed suit to challenge some of the provisions which increase the cost of doing business by the capco but would have no further material effects.

In the event of a threat of decertification by a state, the capco insurer is authorized to assume partial or complete control of a capco which would likely result in financial loss to the capco and possibly us and our shareholders.

Under the terms of insurance policies purchased by all but one of our capcos for the benefit of the investors, the capco insurer is authorized, in the event of a formal written threat of decertification by a state and absent appropriate corrective action by the capco, to assume partial or complete control of a capco in order to avoid final decertification and the requirement to pay compensatory interest to the certified investors under the policies. 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 our business.

RISKS RELATING TO OUR COMMON SHARES

Two of our shareholders, both of whom are executive officers, beneficially own approximately 30% of our common shares, and are able to exercise significant influence over the outcome of most shareholder actions.

Because of their ownership of our shares, Messrs. Sloane and Rubin will be able to have significant influence over actions requiring shareholder approval, including the election of directors, the adoption of amendments to the certificate of incorporation, approval of stock incentive plans and approval of major transactions such as a merger or sale of assets. This could delay or prevent a change in control of our company, deprive our shareholders of an opportunity to receive a premium for their shares of common shares as part of a change in control and have a negative effect on the market price of our common shares.

Future issuances of our common shares or other securities, including preferred shares, may dilute the per share book value of our common shares or have other adverse consequences to our common shareholders.

Our board of directors has the authority, without the action or vote of our shareholders, to issue all or part of the approximately 19,000,000 authorized but unissued shares of our common shares. Our business strategy relies upon investment in and acquisition of businesses using the resources available to

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us, including our common shares. We have made acquisitions during each of the years from 2002 to 2005 involving the issuance of our common shares, and we expect to make additional acquisitions in the future using our common shares. Additionally, we anticipate granting additional options or restricted stock awards to our employees and directors in the future. We may also issue additional securities, through public or private offerings, in order to raise capital to support our growth, including in connection with possible acquisitions or in connection with purchases of minority interests in affiliated companies or capcos. Future issuances of our common shares will dilute the percentage of ownership interest of current shareholders and could decrease the per share book value of our common shares. In addition, option holders may exercise their options at a time when we would otherwise be able to obtain additional equity capital on more favorable terms.

Pursuant to our certificate of incorporation, our board of directors is authorized to issue, without action or vote of our shareholders, up to 1,000,000 shares of blank check preferred shares, meaning that our board of directors may, in its discretion, cause the issuance of one or more series of preferred shares and fix the designations, preferences, powers and relative participating, optional and other rights, qualifications, limitations and restrictions thereof, including the dividend rate, conversion rights, voting rights, redemption rights and liquidation preference, and to fix the number of shares to be included in any such series. The preferred shares so issued may rank superior to the common shares with respect to the payment of dividends or amounts upon liquidation, dissolution or winding-up, or both. In addition, the shares of preferred shares may have class or series voting rights.

The authorization and issuance of blank check preferred shares could have an anti-takeover effect detrimental to the interests of our shareholders.

Our certificate of incorporation allows our board of directors to issue preferred shares with rights and preferences set by the board without further shareholder approval. The issuance of shares of this blank check preferred shares could have an anti-takeover effect detrimental to the interests of our shareholders. For example, in the event of a hostile takeover attempt, it may be possible for management and the board to impede the attempt by issuing the preferred shares, thereby diluting or impairing the voting power of the other outstanding common shares and increasing the potential costs to acquire control of us. Our board has the right to issue any new shares, including preferred shares, without first offering them to the holders of common shares as they have no preemptive rights.

We know of no other publicly-held company that sponsors and operates capcos as a material part of its business. As such, there are, to our knowledge, no other companies against which investors may compare our capco business, operations, results of operations and financial and accounting structures.

In the absence of any meaningful peer group comparisons for our capco business, investors may have a difficult time understanding and judging the strength of our business. This, in turn, may have a depressing effect on the value of our shares.

Provisions of our certificate of incorporation and New York law place restrictions on our shareholders ability to recover from our directors.

As permitted by New York law, our amended and restated certificate of incorporation limits the liability of our directors for monetary damages for breach of a director s fiduciary duty except for liability in certain instances. As a result of these provisions and New York law, shareholders have restrictions and limitations upon their rights to recover from directors for breaches of their duties. In addition, our certificate of incorporation provides that we must indemnify our directors and officers to the fullest extent permitted by law.

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We may not be able to comply in a timely manner with all of the recently enacted or proposed corporate governance requirements.

Beginning with the enactment of the Sarbanes-Oxley Act of 2002, in July 2002, a significant number of new corporate governance requirements have been adopted or proposed by the SEC and the Nasdaq Stock Market. Although we currently expect to comply with all current and future requirements, we may not be successful in complying with these requirements in the future. In addition, certain of these requirements may require us to make changes to our corporate governance.

Item 2. PROPERTIES.

We conduct our principal business activities in facilities leased from unrelated parties at market rates. We maintain offices in New York, New York, Great River, New York and South Salem, New York. In addition, our capcos maintain offices in each of the states in which they operate. With regard to our operating subsidiaries, CrystalTech Web Hosting, Inc. has a property which is material in the conduct of its business in Phoenix, Arizona. The building is under lease to the previous owner of the company, Mr. Uzzanti, and is subleased to CrystalTech without markup on the rental. The space occupied by CrystalTech is approximately 12,000 square feet with a current annual rental of $168,000 plus certain pass through expenses. The lease runs through April 2007 and CrystalTech plans to move to larger space at that time.

Item 3. LEGAL PROCEEDINGS.

We are not involved in any material pending litigation. We and/or one or more of our investee companies are involved in 4 lawsuits regarding wrongful termination claims by employees or consultants, none of which are individually or in the aggregate material to Newtek. See Note 17 to Consolidated Financial Statements.

In 2004 our Colorado capco initiated a lawsuit challenging the provisions of then recent amendments to the capco statute and the implementing regulations. The suit has made little progress but may come to trial during 2006. Because of the lack of clarity of the amended statutory and regulatory provisions, it has been impossible for management to gauge with any certainty the likely liability if any to our capco. Even if the effect is material to the capco, however, management does not expect it to be material to the financial condition of Newtek taken as a whole.

PART II

Item 5. MARKET FOR THE REGISTRANT S COMMON STOCK AND RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

(a) Market Information: Our common stock is traded on the Nasdaq National Stock Market under the symbol NKBS. High and low prices for the common stock over the previous two years is set forth below, based on the highest and lowest trading price during that period.

Period	High	Low
First Quarter: January 1, 2004 Through March 31, 2004	$ 7.95	$ 4.34
Second Quarter: April 1, 2004 Through June 30, 2004	$ 6.15	$ 3.65
Third Quarter: July 1, 2004 Through September 30, 2004	$ 4.00	$ 2.80
Fourth Quarter: October 1, 2004 Through December 31, 2004	$ 4.50	$ 3.41
First Quarter: January 1, 2005 Through March 31, 2005	$ 4.33	$ 3.56
Second Quarter: April 1, 2005 Through June 30, 2005	$ 4.00	$ 2.12
Third Quarter: July 1, 2005 Through September 30, 2005	$ 2.84	$ 1.95
Fourth Quarter: October 1, 2005 Through December 31, 2005	$ 2.19	$ 1.54
First Quarter: January 1, 2006 Through March 31, 2006	$ 2.21	$ 1.70
Second Quarter: April 1, 2006 Through May 8, 2006	$ 2.75	$ 1.91

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(b) Holders: As of December 31, 2005 there were approximately 286 holders of record of the common shares of Newtek.

(c) Dividends: Newtek has never paid a cash or in-kind dividend and currently has no plan or policy with respect to the payment of dividends.

(d) Securities Authorized for Issuance Under Equity Compensation Plans:

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	2,245,844 shares	$ 3.23 /share (1)	3,004,156 shares
Equity compensation plans not approved by security holders	None	None	None

(1) Excludes 178,509 restricted shares rights which have a zero exercise price.

(e) During the quarter ended December 31, 2005 our only sale of unregistered securities was the issuance of 472,814 of our common shares as a contribution to one of our wholly-owned subsidiaries which used the shares as partial consideration in the assumption of assets and liabilities of another subsidiary. See the discussion of the Newtek Insurance Agency, above. The shares were valued at $2.115 per share, or a total of $1 million.

Item 6. SELECTED FINANCIAL DATA.

FIVE-YEAR HIGHLIGHTS

The following selected statement of income data for the fiscal years ended December 31, 2005, December 31, 2004 and December 31, 2003 and the selected balance sheet data as of December 31, 2005 and December 31, 2004 are derived from the Company s Consolidated Financial Statements including the Notes thereto which have been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, appearing elsewhere in this Form 10-K. The selected statement of income data for the fiscal years ended December 31, 2002 and December 31, 2001, and the selected balance sheet data as of December 31, 2003, December 31, 2002 and December 31, 2001, have been derived from our financial statements not included herein, which have been audited by PricewaterhouseCoopers LLP. The comparability of the information below is affected by the acquisitions of CrystalTech Web Hosting, Inc. (CrystalTech) in July 2004, and Vistar Insurance Agency, Inc., (Vistar or Keyosk) in July 2004 and Automated Merchant Services, Inc. (Automated Merchant Services or AMS) in August 2003. The selected financial data set forth below should be

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read in conjunction with, and is qualified by reference to, Management s Discussion and Analysis of Financial Condition and Results of Operations and our Consolidated Financial Statements, including the Notes thereto, appearing elsewhere in this report.

	FISCAL YEARS ENDED				
	Dec. 31 2005	Dec. 31 2004	Dec. 31 2003	Dec. 31 2002	Dec. 31 2001
	(In Thousands Except for Per Share Data)				
Revenue:					
Income from tax credits	$ 36,669	$ 33,565	$ 44,933	$ 30,603	$ 21,498
Electronic payment processing	31,128	18,131	6,297	1,585	121
Web hosting	10,627	4,428			
Interest income	4,844	3,834	4,059	900	1,845
Premium income	4,409	4,533	1,284		
Servicing fee	1,950	1,717	1,418		
Insurance commissions	1,203	560			
Other income	5,969	3,412	2,502	1,581	441
Total revenue	96,799	70,180	60,493	34,669	23,905
Expenses:					
Electronic payment processing costs	22,928	12,842	4,513	632	42
Consulting, payroll and benefits	16,236	10,843	8,407	4,565	2,665
Interest	16,027	14,039	13,879	11,485	11,577
Professional fees	7,876	5,183	4,500	3,145	2,061
Depreciation and amortization	4,549	2,459	504	148	74
Insurance	3,144	2,818	2,469	1,951	1,530
Provision for loan losses	2,258	205	473		
Goodwill impairment	878		1,435		
Other than temporary decline in value of investments	395		1,996	1,602	476
Write-down of asset held for sale to net realizable value					168
Equity in net losses of affiliates				729	2,280
Other	8,719	5,599	4,247	2,895	1,059
Total expenses	83,010	53,988	42,423	27,152	21,932
Income before minority interest, provision for income taxes and extraordinary items	13,789	16,192	18,070	7,517	1,973
Minority interest	730	890	(1,598)	(335)	(509)
Income before provision of income taxes and extraordinary items	14,519	17,082	16,472	7,182	1,464
Provision for income taxes	(6,792)	(6,467)	(7,090)	(2,657)	(534)
Income before extraordinary items	7,727	10,615	9,382	4,525	930
Extraordinary gain on acquisition of minority interests				908	
Extraordinary gain on acquisition of a business			187	2,735	
Net income	$ 7,727	$ 10,615	$ 9,569	$ 8,168	$ 930
Weighted average common shares outstanding					
Basic	34,241	30,068	25,777	24,184	21,890
Diluted	34,280	30,379	26,177	24,294	21,910
Income per share after extraordinary gain					
Basic	$ .23	$ .35	$ .37	$ .34	$ .04

Diluted	$ .23	$ .35	$ .37	$ .34	$ .04
Income per share before extraordinary gain					
Basic	$ .23	$ .35	$ .36	$ .19	$ .04
Diluted	$ .23	$ .35	$ .36	$ .19	$ .04
Balance Sheet Data (at end of period):					
Total assets	$ 265,013	$ 228,398	$ 192,184	$ 169,055	$ 83,363
Bank notes payable	21,287	27,988	51,990	53,824	
Notes payable in credits in lieu of cash	92,048	76,259	65,625	65,196	49,641
Deferred tax liability	24,271	16,617	10,816	3,726	1,563
Minority interest	5,033	5,721	8,393	4,773	5,081
Shareholder s equity	87,525	77,095	40,248	27,172	11,392
Common shares outstanding at year end	34,809	33,873	26,209	25,341	22,213
Shareholder s equity per share	$ 2.51	$ 2.28	$ 1.54	$ 1.07	$ 0.51

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Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Introduction and Certain Cautionary Statements

The following discussion and analysis of our financial condition and results of operations is intended to assist in the understanding and assessment of significant changes and trends related to the results of operations and financial position of the Company together with its subsidiaries. This discussion and analysis should be read in conjunction with the consolidated financial statements and the accompanying notes.

The statements in this Annual Report may contain forward-looking statements relating to such matters as anticipated future financial performance, business prospects, legislative developments and similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, we note that a variety of factors could cause our actual results to differ materially from the anticipated results expressed in the forward looking statements such as intensified competition and/or operating problems on its operating business projects and their impact on revenues and profit margins or additional factors as described in Newtek Business Services previously filed registration statements.

We also need to point out that our capcos operate under a different set of rules in each of the 8 jurisdictions and that these place varying requirements on the structure of our investments. In some

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cases, particularly in Louisiana, we don t control the equity or management of a qualified business but that cannot always be presented orally or in written presentations.

Executive Overview

Newtek continues its transition out of our capco-dominated business model. Our core businesses of merchant processing, web hosting and small-business lending are growing at high rates and in aggregate produced $11.7 million of EBITDA in 2005.

In March 2006, we paid off $4 million in notes from Technology Investment Capital Corp., and are making efforts to increase our cash flow through operations and grow dominant companies that market to the small- and medium-sized business market.

We have what we believe is great technology that forms the basis for our current client base, now in excess of 60,000, which we would expect to continue to grow rapidly. We will use our proprietary technology to build a quality brand of financial and business services in the small- and medium-sized business space.

We have reported on our balance sheet at December 31, 2005 $63 million in aggregate of cash, cash equivalents, short-term treasuries and marketable securities; $87 million in shareholder equity and $2.51 in book value per share. Our shareholders equity has grown significantly through the years, from $22 million in 2002 to $87.5 million in 2005, even after the secondary stock offering completed in 2004, as our book value per diluted share has grown from $1.07 in 2002 all the way to $2.51 in 2005.

Newtek is a distribution channel whose primary target is the national small- and medium-sized business market, a very significant marketplace in the United States. Approximately 51% of GDP in the United States come from small-business. There are 23 million potential clients, and nine out of 10 businesses in the United States fit into this particular segment. Newtek is achieving its goal by becoming a premier provider of business and financial services for those 60,000 small- and medium-sized business clients in its portfolio. We are a low-cost provider of products and services and a low-cost supplier of small- and medium-sized business clients, and that is based upon how we do business.

We are accomplishing our goal primarily by using state-of-the-art Web-based proprietary technologies. Our Web-based referral system is growing in terms of its popularity and its attractive features. By using this Web-based referral system, referral partners are allowed to have a complete window into our back-office operations. Every communication, every activity, everything that we are doing with the referred client, can be seen from the first day to the end of the transaction. It is very similar to how delivery services puts a bar code on a package. If you want to call up at any point in the process, you could find out exactly where that package is. We effectively are putting a bar code on business services and financial services for our alliance partners. We use Web-based applications as an in-house tool to make our employees and associates efficient, smart and productive. Instead of using expensive six-figured salaried employees that a typical bank or an insurance company would use to market financial products and business services to small- and medium-sized business customers, we use very smart, efficient, high-quality technology and dedicated loyal non-executive salary plus bonus employees.

This technology enables us to provide a high-quality service. We don t ask our clients to type in data or handwrite applications. We do that for them in a telephonic interview. We have

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modeled our back-office and business operations after the successful Progressive and GEICO insurance operational model. Our technology has been accepted and used by companies such as, Merrill Lynch, the Credit Union National Association with its 9,100 credit unions and their 87 million members, the Navy Federal Credit Union, and others. All of these entities have realized it is better to outsource their business services and financial products to Newtek than try to provide this product and service for their customer themselves.

New Technology Launches one of the things Newtek will be doing within the next quarter will be launching a new website. Our new website will be designed to be more of an interactive tool and more of a business tool rather than just a billboard for investor relations. We plan on giving entities such as insurance agents, CPAs, lawyers and accountants that might have relationships with small- and medium-sized business owners and who would like to refer business to us a personally prepared website. These professionals will be able to refer their customers to their own website and give them the ability to pass on to us a small-business loan referral, an insurance referral, a Web-hosting referral, a data storage referral, bookkeeping, etc.

Management is intent on building the core businesses and reducing the non-core businesses. Our client base is growing rapidly and, importantly, the proportion of our non-tax-credit revenue is growing significantly year after year. Our operating business lines created $11.7 million of EBITDA in 2005. Our debt is manageable and could be paid off without much difficulty. In March 2006, we made a $4 million pre-payment with $4 million remaining against our TICC notes. Our systems, product and technology are constantly being upgraded, and we are further developing this to be the number one provider of business services and financial products to the small and medium sized business market.

The overhead and non-core business units are being pared back to reduce cash flow drain. The business is in transition: capco business and market segment is being deemphasized for a number of reasons. Primarily, the lack of new state legislation reduced product creation. Capcos historically, from 1999 to 2005, have created approximately $10 to $15 million of pretax cash flow a year for Newtek. Because of changes in the market, we are replacing that pretax cash flow by growing the underlying businesses. We currently have enough capital to accomplish our business model without having to generate new capco funds to acquire and operate small- and medium-sized businesses. Newtek and its management believe that there is a much greater value in developing a leading brand of products and services for the small- and medium-sized business

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market versus continuing to create certified capital companies. The small- and medium-sized business market is valuable and we are gaining a larger stake every day.

Part of our strategy for 2006 will be the acquisition of approximately $10 million of merchant processing portfolios. We recently completed a $2.5 million purchase of merchant accounts with a an additional expected purchase within the next 60 days of $7.5 million. These acquisitions will add additional processing platforms to enable us to bring in 6,000 new merchant servicing customers, and almost $600 million of processing volume.

Results of Operations

Consistent with management s focus, the revenue and expenses from the consolidated operating entities, specifically the SBA lending, electronic payment processing and web hosting operations continue to increase as a percentage of revenue, with a correlating decrease in revenues from capco-related tax credits. The following table sets forth certain data from our statements of income, expressed as a percentage of total revenues, for each of the periods presented.

	FISCAL YEARS ENDED		
	Dec. 31 2005	Dec. 31 2004	Dec. 31 2003
Revenues:			
Income from tax credits	37.9%	47.9%	74.3%
Electronic payment processing	32.2%	25.8%	10.4%
Web hosting	11.0%	6.3%	0.0%
Interest income	5.0%	5.5%	6.7%
Premium income	4.6%	6.5%	2.2%
Servicing fee	2.0%	2.4%	2.3%
Insurance commissions	1.2%	0.8%	0.0%
Other income	6.1%	4.8%	4.1%
Total revenues	100.0%	100.0%	100.0%
Expenses:			
Electronic payment processing costs	23.7%	18.3%	7.5%
Consulting, payroll and benefits	16.8%	15.5%	13.9%
Interest	16.6%	20.0%	22.9%
Professional fees	8.1%	7.4%	7.4%
Depreciation and amortization	4.7%	3.5%	0.8%
Insurance	3.2%	4.0%	4.1%
Provision for loan losses	2.3%	0.3%	0.8%
Goodwill impairment	0.9%	0.0%	2.4%
Other than temporary decline in value of investments	0.4%	0.0%	3.3%
Other	9.1%	8.0%	7.0%
Total expenses	85.8%	77.0%	70.1%
Income before minority interest, provision for income taxes and extraordinary items	14.2%	23.0%	29.9%
Minority interest	0.8%	1.3%	(2.6)%
Income before provision for income taxes, and extraordinary items	15.0%	24.3%	27.3%
Provision for income taxes	(7.0)%	(9.2)%	(11.8)%
Income before extraordinary items	8.0%	15.1%	15.5%
Extraordinary gain on acquisition of a business	0.0%	0.0%	0.3%

Net income	8.0%	15.1%	15.8%

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Comparison of the years ended December 31, 2005 and December 31, 2004

Revenues increased by $26,619,000 to $96,799,000 for the year ended December 31, 2005, from $70,180,000 for the year ended December 31, 2004. Income from tax credits increased by $3,104,000, to $36,669,000 for the year ended December 31, 2005 from $33,565,000 for the year ended December 31, 2004, due to Newtek s capcos achieving various additional investment thresholds, as well as additional accretion of income in 2005 versus 2004.

Electronic payment processing revenue increased by $12,997,000 to $31,128,000 for the year ended December 31, 2005, from $18,131,000 for the year ended December 31, 2004, due to the increase in electronic payment processing customers, the acquisition of a merchant portfolio in April 2005, and the additional electronic processing sales entity formed in Alabama during August 2004. At December 31, 2005, we provided our payment services to over 11,000 small merchants across the United States, compared to 8,000 customers at December 31, 2004. Gross total processing volume increased to $1,469,266,000 from all merchant portfolios (of this amount, $300,296,000 of processing volume generated revenues that were recorded net of interchange fees) for the year ended December 31, 2004 from $1,025,000,000 of gross processing volume (of this amount, $406,000,000 of processing volume generated revenues that were recorded net of interchange fees) for the year ended December 31, 2004.

Web hosting income increased by $6,199,000 to $10,627,000 for the year ended December 31, 2005 from $4,428,000 for the year ended December 31, 2004 due to the fact that CrystalTech Web Hosting was acquired on July 7, 2004. The increase is due to the number of customers the Company provided services to. At December 31, 2005 and 2004, CrystalTech was providing services to 46,000 and 24,000 customers, respectively.

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

(In thousands)	2005	2004	Change
NSBF activities	$ 3,490	$ 3,316	$ 174
Non-cash accretions	175	176	(1)
Qualified investments	159	51	108
Treasury and other	1,020	291	729
	$ 4,844	$ 3,834	$ 1,010

The increase generated from treasury and other investments is attributable to an increase in the average outstanding balances as US Treasury Notes and Short term investments were made late in Q4 2005 and increased interest rates (generally a 1-2% increase) on interest bearing cash accounts for the year ended December 31 2005 compared to the prior year.

Premium income decreased by $124,000 to $4,409,000 for the year ended December 31, 2005 from $4,533,000 for the year ended December 31, 2004. The decrease in premium income was attributable to NSBF selling 166 guaranteed loans in the year ended December 31, 2005, aggregating $44,988,000 as compared to 159 loans sold aggregating $38,200,000 in the same period for the prior year. The premiums recognized in connection with these sales were $3,676,000 for the year ended December 31, 2005 as compared with $3,321,000 in the same period for the prior year. In addition, in the year ended December 31, 2005, NSBF sold to three financial institutions $8,522,000 of loans previously classified as held for investment for aggregate proceeds of $8,827,000. This represented a portion of the unguaranteed piece of 113 loans. The carrying value above the $8,522,000 of loans previously classified as held for investment of $305,000 was recorded as premium income. Also, in connection with this sale, included in premium income for the year ended December 31, 2005 is $428,000 representing the allocated portion of the remaining discount recorded at the time of loan origination. During the year ended December 31, 2004, NSBF sold to two financial institutions $23,027,000 of loans previously classified as held for investment for aggregate proceeds of $23,891,000. The proceeds above the carrying value above the $23,027,000 of loans previously classified as held for investment of $864,000 was recorded as premium income. Also, in connection with this sale, included in premium income for the year ended December 31, 2004 is $348,000 representing the allocated portion of the remaining discount recorded at the time of loan origination. Additionally, in July 2004, NSBF sold $201,000 of loans previously classified as held for investment for aggregate proceeds of approximately $220,000. This represented a guaranteed portion of one loan. The difference of $19,000 was recorded as premium income.

Servicing fee income related to SBA loans increased by $233,000 to $1,950,000 for the year ended December 31, 2005 from $1,717,000 for the year ended December 31, 2004. The increase in servicing fee income was attributable to the servicing portfolio s growth year over year. The portfolio in which we earn servicing fee income at December 31, 2005 aggregated $151,827,000 as compared with $135,287,000 at December 31, 2004.

Insurance commissions increased by $643,000 to $1,203,000 for the year ended December 31, 2005 from $560,000 for the year ended December 31, 2004 due to the fact that Vistar Insurance Agency was acquired on July 31, 2004.

Other income increased by $2,557,000 to $5,969,000 for the year ended December 31, 2005 from $3,412,000 for the year ended December 31, 2004. This increase primarily relates to the equity in earnings of $993,000 from Exponential Business Development Co., L.P., $929,000 of lodging revenues from Phoenix, a subsidiary that operates a hotel in Louisiana primarily housing workers to assist in the redevelopment after Hurricane Katrina , and $700,000 from Citibank for early termination of our contract with them.

Electronic payment processing direct costs increased by $10,086,000 to $22,928,000 for the year ended December 31, 2005 from $12,842,000 for the year ended December 31, 2004, an increase of 80%, which correlates to the significant increase in this business.

Consulting, payroll and benefits increased by $5,393,000 to $16,236,000 for the year ended December 31, 2005 from $10,843,000 for the year ended December 31, 2004. The increase was primarily due to the increased employee headcount from 250 to approximately 360 employees.

Changes in interest expense are summarized as follows:

(In thousands)	2005	2004	Change
Capco interest expense	$ 12,684	$ 11,656	$ 1,028
NSBF (SBA Lender) interest expense	2,012	1,704	308
Other interest expense	1,331	679	652
	$ 16,027	$ 14,039	$ 1,988

The increase in capco expense relates to the two new capcos formed in 2005 (WT1 and WNY5) as well as the three capcos formed in 2004 (WAP, WDC and WNY4) had a full year of expense in 2005 compared to a partial year in 2004. The increase in SBA lender interest expense was primarily due to the increase in the prime interest rate in 2005 compared to 2004 as well as the new financing rate, offset by a decrease in the outstanding bank notes payable balance. The $652,000 increase in other interest expense is primarily related to interest on the TICC note of $679,000 offset by a decrease in interest expense for notes payable insurance and other.

Professional fees increased by $2,693,000 to $7,876,000 for the year ended December 31, 2005 from $5,183,000 for the year ended December 31, 2004. This increase is attributable to $785,000 of residual expenses for merchant processing commissions, and approximately $1,800,000 due to the legal and audit services provided in 2005 as compared to 2004.

Depreciation and amortization expense increased by approximately $2,090,000 to $4,549,000 for the year ended December 31, 2005 from $2,459,000 for the year ended December 31, 2004. This is due to the $6,000,000 increase in the customer accounts and fixed assets in 2005 compared to 2004.

Insurance expense increased by $326,000 to $3,144,000 for the year ended December 31, 2005 from $2,818,000 for the year ended December 31, 2004. This increase is due to the additional insurance relating to the new capcos in 2005 (Wilshire Texas Partners I, LLC, and Wilshire New York Partners, V, LLC), as well as the fact that three capco s (Wilshire Alabama Partners, LLC, Wilshire New York Partners IV, LLC and Wilshire DC Partners, LLC) had a full year of insurance expense amortization in 2005 compared to a partial year in 2004 .

Provision for loan losses increased by $2,053,000 to $2,258,000 for the year ended December 31, 2005 from $205,000 for the year ended December 31, 2004. This increase was due to significant charge-offs in 2005, effects of hurricane Katrina and increased risk from economic factors such as higher fuel costs, increased medical costs and higher interest rates. These factors required management to establish an additional provision in order to maintain its allowance for loan losses at a level which management believes adequately covers inherent losses in the existing loan portfolio. NSBF s charge-offs, in both the acquired CCC portfolio as well as newly originated loans, significantly increased by $1,527,000 to $1,914,000 for the year ended December 31, 2005 from $387,000 for the year ended December 31, 2004 due to the completion of the liquidation process on certain loans from the acquired CCC portfolio and unexpected credit events from the acquired portfolio and newly originated loans.

Management s ongoing estimates of the allowance for loan losses are particularly affected by the changing composition of the loan portfolio over the last few years. The loans acquired from CCC in December 2002, which are more seasoned than those originated by NSBF, comprise 33% of total loans held for investment as of December 31, 2005. Other portfolio characteristics, such as industry concentrations and loan collateral, which also impacts management s estimates of the allowance for loan losses, have also changed since the acquisition. The changing nature of the portfolio and the limited past loss experience on the newly originated portfolio has resulted in management s estimates of the allowance for loan losses being based more on subjective factors and less on empirically derived loss rates. Such estimates could differ from actual results, which may have a material effect on the Company s results of operations or financial condition.

Additionally, in the third quarter of 2005, management recorded an additional $900,000 in reserves, of which $300,000 is associated with hurricane Katrina. The $300,000 reserve was established to cover known and probable future losses due to business interruptions and material property losses, as well as indirect economic effects outside of the hurricane region which could result in decreases in revenue to some of our other borrowers. The remaining $600,000 reserve was established due to current economic conditions, specifically the rising interest rate environment and the high price of oil and gas, in addition to the potential economic impact to those small businesses in Louisiana, Alabama, Mississippi and other parts of the country that were not directly impacted by the storm as addressed in the reserves above. Consideration in this evaluation includes past and current loss experience, current portfolio composition and the evaluation of real estate collateral as well as current economic conditions. Management believes that such additional reserves will be adequate to

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absorb probable loan losses inherent in the Company s entire loan portfolio. The remaining increase of $353,000 is attributable to general reserves being recorded on newly originated loans. Additionally, in June 2004, NSBF sold loans to a bank previously classified as held for investment. In connection with this sale, NSBF reversed the reserve for loan losses associated with these loans and recorded a benefit of $300,000, offset by $241,000 in loan loss provisions.

In accordance with the provisions of Statement of Financial Accounting Standards No. 142 Goodwill and other Intangible Assets (SFAS 142), Newtek assessed the carrying value of goodwill recorded on the consolidated balance sheet and determined that the fair values of the reporting units to which goodwill was attributable were less than their carrying values for the year ended December 31, 2005. As a result, the Company completed the impairment analysis required by SFAS 142 and recorded $878,000 of an impairment charge in the accompanying consolidated statement of income for the year ended December 31, 2005. There was no impairment for the year ended December 31, 2004.

Newtek considers several factors in determining whether an impairment exists on its investments, 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.

Other than temporary decline in value of investments increased by $395,000 to $395,000 for the year ended December 31, 2005 from zero for the year ended December 31, 2004, due to the Company s determination that a greater amount of its investment values were impaired in 2005 versus no impairments in 2004. During the year ended December 31, 2005, Newtek determined that there was $200,000 of an other than temporary decline in the value of one if its equity investments, $177,000 for a debt investment and $18,000 for smaller cost method equity investment from one of our investment Bidco s in Louisiana.

Other expenses (consisting of dues and licenses, office expenses, rent, utilities, travel and entertainment and other) increased by $3,120,000 to $8,719,000 for the year ended December 31, 2005 from $5,599,000 for the year ended December 31, 2004. The increase was due primarily to expenses incurred by the 11 additional consolidated operating entities in 2005 compared to 2004. Specifically, the operations of CrystalTech and Newtek Insurance Agency (formerly Vistar, acquired in July 2004) contributed approximately $1,671,000 to the increase in other expenses in 2005 as total other expenses were $2,748,000 for the year ended December 31, 2005 compared to $1,077,000 in 2004. The increase in overall other expenses also relates to $289,000 of additional computer and network maintenance expenses , $179,000 of servicing asset impairment and the 11 additional consolidated operating entities in 2005 compared to 2004.

The Company s effective tax rate increased to 46.8% in 2005 from 37.9% in 2004. The 2005 state and local tax rate, net of federal benefit, increased to 8.9% in 2005 from 5.2% in 2004. In addition, in 2005 the Company recorded a $299,000 provision due to goodwill impairment and a $324,000 provision due to an increase in a deferred tax asset valuation compared with a $235,000 benefit from a reduction in a deferred tax asset valuation in 2004.

Net income decreased by $2,888,000, to net income of $7,727,000 for the year ended December 31, 2005, compared to net income of $10,615,000 for the year ended December 31, 2004, due to the increases in revenue of $26,619,000 offset by total expenses of $29,022,000 discussed above, the increase in the taxes of $325,000, and the decrease in minority interest of $160,000.

Comparison of the years ended December 31, 2004 and December 31, 2003

Revenues increased by $9,687,000 to $70,180,000 for the year ended December 31, 2004, from $60,493,000 for the year ended December 31, 2003. Income from tax credits decreased by $11,368,000, from $44,933,000 for the year ended December 31, 2003, to $33,565,000 for the year ended December 31, 2004, due to Newtek s capcos achieving various additional investment thresholds mandated by the various state/jurisdiction capco statutes in 2003 versus 2004.

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Electronic payment processing revenue increased by $11,834,000 to $18,131,000 for the year ended December 31, 2004, from $6,297,000 for the year ended December 31, 2003, due to the Company s increase in electronic payment processing customers, the additional electronic processing sales entity formed in Alabama during August 2004, and the company s acquisition of Automated Merchant Services on August 7, 2003. At December 31, 2004, we provided our payment services to over 8,000 small merchants across the United States, compared to approximately 5,000 customers at December 31, 2003. Gross total processing volume increased to approximately $1,025,000,000 from all merchant portfolios (of this amount, approximately $406,000,000 of processing volume generated revenues that were recorded net of interchange fees) for the year ended December 31, 2004 from approximately $320,000,000 of gross processing volume (of this amount, approximately $110,000,000 of processing volume generated revenues that were recorded net of interchange fees) for the year ended December 31, 2003. In addition, in June 2004, our electronic payment processing segment sold approximately 600 merchant accounts for net proceeds of $147,000.

Web hosting income increased by $4,428,000 to $4,428,000 for the year ended December 31, 2004 from zero for the year ended December 31, 2003 due to the fact that CrystalTech Web Hosting was acquired on July 7, 2004. At December 31, 2004, CrystalTech was providing services to over 34,000 customers.

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

(In thousands)	2004	2003	Change
NSBF activities	$ 3,316	$ 3,543	$ (227)
Non-cash accretions	176		