

NEWTEK BUSINESS SERVICES INC

FORM 10-Q (Quarterly Report)

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Industry	Business Services
Sector	Services
Fiscal Year	12/31

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

OR

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

For the transition period from _____ to _____

Commission File Number: 001-16123

NEWTEK BUSINESS SERVICES, INC.

(Exact name of registrant as specified in its charter)

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

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

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

10018
(Zip Code)

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

Indicate by checkmark whether the registrant has (1) filed all documents and reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past ninety days. Yes ☒ No ☐

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

Large Accelerated Filer ☐ Accelerated Filer ☐ Non-Accelerated Filer ☒

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

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

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Item 1. Financial Statements (Unaudited)

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2007 AND 2006
(In Thousands, except for Per Share Data)

	Three Months ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Revenue:				
Electronic payment processing	\$13,013	\$10,510	\$25,530	\$19,942
Web hosting	3,943	3,310	7,820	6,474
Interest income	1,546	1,923	3,038	3,336
Income from tax credits	1,320	2,022	2,621	3,280
Premium income	797	763	1,513	1,377
Servicing fee	496	487	940	986
Insurance commissions	207	188	445	432
Other income	2,089	223	3,313	745
Total revenue	<u>23,411</u>	<u>19,426</u>	<u>45,220</u>	<u>36,572</u>
Expenses:				
Electronic payment processing costs	9,654	7,555	18,624	14,462
Consulting, payroll and benefits	5,224	4,075	10,737	8,121
Interest	3,614	4,577	7,336	8,885
Professional fees	2,183	1,874	4,002	3,928
Depreciation and amortization	1,803	1,527	3,531	2,882
Insurance	873	840	1,686	1,703
Provision for loan losses	205	235	372	354
Other general and administrative costs	2,729	2,300	5,996	4,659
Total expenses	<u>26,285</u>	<u>22,983</u>	<u>52,284</u>	<u>44,994</u>
Loss from continuing operations before minority interest, benefit for income taxes, and discontinued operations	(2,874)	(3,557)	(7,064)	(8,422)
Minority interest	56	97	180	330
Loss from continuing operations before benefit for income taxes and discontinued operations	(2,818)	(3,460)	(6,884)	(8,092)
Benefit for income taxes	717	1,114	2,089	2,721
Loss from continuing operations before discontinued operations	(2,101)	(2,346)	(4,795)	(5,371)
Discontinued operations, net of taxes	(286)	59	(491)	356
Net loss	<u>\$ (2,387)</u>	<u>\$ (2,287)</u>	<u>\$ (5,286)</u>	<u>\$ (5,015)</u>
Weighted average common shares outstanding:				
Basic and diluted	35,868	34,696	35,720	34,765
Loss per share from continuing operations:				
Basic and diluted	\$ (0.06)	\$ (0.07)	\$ (0.13)	\$ (0.15)
(Loss) income per share from discontinued operations, net of taxes:				
Basic and diluted	(0.01)	(0.00)	(0.02)	0.01
Basic and diluted loss per share	<u>\$ (0.07)</u>	<u>\$ (0.07)</u>	<u>\$ (0.15)</u>	<u>\$ (0.14)</u>

See accompanying notes to these unaudited condensed consolidated financial statements

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

	June 30, 2007 (Unaudited)	December 31, 2006 (Note 1)
ASSETS		
Cash and cash equivalents	\$ 28,015	\$ 26,685
Restricted cash	8,966	11,275
U.S. Treasury notes	2,950	5,016
Asset held for sale	—	1,530
Credits in lieu of cash	99,054	106,425
SBA loans held for investment (net of reserve for loan losses of \$2,598 and \$2,332, respectively)	25,998	27,746
Accounts receivable (net of allowance of \$352 and \$23, respectively)	5,301	1,568
SBA loans held for sale	2,363	1,786
Accrued interest receivable	517	519
Investments in qualified businesses - cost method investments	504	542
Investments in qualified businesses - held to maturity debt investments	1,919	5,301
Prepaid and structured insurance	16,118	17,497
Prepaid expenses and other assets (net of accumulated amortization of deferred financing costs of \$1,178 and \$832, respectively)	6,820	7,682
Servicing assets (net of accumulated amortization of \$2,561 and \$2,081, respectively)	3,016	2,991
Fixed assets (net of accumulated depreciation and amortization of \$5,336 and \$4,065, respectively)	4,706	4,458
Intangible assets (net of accumulated amortization of \$7,637 and \$5,919, respectively)	8,034	9,141
Goodwill	13,055	10,575
Total assets	<u>\$ 227,336</u>	<u>\$ 240,737</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Accounts payable and accrued expenses	\$ 10,242	\$ 8,509
Notes payable	5,964	10,651
Bank notes payable	16,696	16,391
Deferred revenue	2,379	2,761
Notes payable in credits in lieu of cash	82,400	86,332
Deferred tax liability	21,734	24,428
Total liabilities	<u>139,415</u>	<u>149,072</u>
Minority interest	5,246	4,596
Commitments and contingencies		
Shareholders' equity:		
Preferred stock (par value \$0.02 per share; authorized 1,000 shares, no shares issued and outstanding)	—	—
Common stock (par value \$0.02 per share; authorized 54,000 shares, issued and outstanding 35,910 and 35,479 not including 583 shares held in escrow and 473 shares held by affiliate)	718	710
Additional paid-in capital	55,858	54,949
Retained earnings	26,177	31,464
Treasury stock, at cost (44 and 32 shares at June 30, 2007 and December 31, 2006, respectively)	(78)	(54)
Total shareholders' equity	<u>82,675</u>	<u>87,069</u>
Total liabilities and shareholders' equity	<u>\$ 227,336</u>	<u>\$ 240,737</u>

See accompanying notes to these unaudited condensed consolidated financial statements

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NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
FOR THE SIX MONTHS ENDED JUNE 30, 2007 AND 2006
(In Thousands)

	2007	2006
Cash flows from operating activities:		
Net loss	\$ (5,286)	\$ (5,015)
Adjustments to reconcile net loss to net cash used in operating activities:		
Income from tax credits	(2,621)	(3,280)
Deferred income taxes	(2,695)	(2,435)
Depreciation and amortization	3,531	3,012
Capitalization of servicing asset	(504)	(428)
Gain on sale/recoveries of investments in qualified businesses	(1,032)	—
Accretion of interest expense	6,082	6,663
Loss on redemption of U.S. Treasury notes	13	—
Provision for loan losses	372	354
Accretion of interest income	(100)	(7)
Equity in earnings of investee	(177)	(98)
Loss on sale of other real estate owned	247	—
Gain on sale of land and building	—	(308)
Gain on sale of asset held for sale	(198)	—
Loss on disposal of fixed assets	—	25
Gain on sale of loans held for investment	(93)	(189)
Stock-based compensation	262	311
Amortization of deferred loan origination fees, net	(188)	(105)
Minority interest	272	(259)
Changes in assets and liabilities, net of the effect of business acquisitions:		
Originations of SBA loans held for sale	(14,284)	(16,417)
Proceeds from sale of SBA loans held for sale	13,707	14,326
Premium on repurchase of portfolio	—	44
Prepaid insurance	1,480	1,487
Prepaid expenses, accounts receivable, accrued interest receivable from bank and other assets	980	(532)
Restricted cash	(1,757)	—
Accounts payable, accrued expenses and deferred revenue	(1,480)	456
Net cash used in operating activities	(3,469)	(2,395)
Cash flows from investing activities:		
Investments in qualified businesses	—	(6,250)
Return of investments in qualified businesses	1,370	6,304
Purchase of fixed assets	(1,659)	(1,392)
Purchase of customer merchant accounts	(166)	(2,531)
Cash addition from acquired interests	233	—
Cash reduction from deconsolidation of acquired interests	(56)	—
SBA loans originated for investment, net	(4,321)	(5,019)
Cash paid for repurchase of SBA loans	—	(1,214)
Proceeds from sale of SBA loans held for investment	1,950	4,173
Payments received on SBA loans	3,993	3,373
Proceeds from sale of land and building	—	1,300
Proceeds from sale of asset held for sale and insurance recoveries	1,572	—
Proceeds from sale/recoveries of investments in qualified businesses	492	—
Change in restricted cash	4,066	1,812
Proceeds from sale of U.S. Treasury Notes, marketable securities and certificates of deposit	2,081	14,001
Other investments	—	(4)
Net cash provided by investing activities	9,555	14,553

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

	2007	2006
Cash flows from financing activities:		
Proceeds from notes payable	5,073	299
Repayments of notes payable	(8,766)	(9,414)
Change in restricted cash related to CDS financing	2,050	—
Net (borrowings) proceeds on bank notes payable	(2,954)	722
Distributions to minority member	(597)	—
Payments for deferred financing costs	(165)	—
Purchase of treasury stock	(24)	—
Net proceeds from option exercise	141	—
Net proceeds from issuance of common stock and other	486	(267)
Net cash used in financing activities	<u>(4,756)</u>	<u>(8,660)</u>
Net increase in cash and cash equivalents	1,330	3,498
Cash and cash equivalents - beginning of period	26,685	23,940
Cash and cash equivalents - end of period	<u>\$28,015</u>	<u>\$27,438</u>
Supplemental disclosure of cash flow activities:		
Reduction of credits in lieu of cash and notes payable in credits in lieu of cash balances due to delivery of tax credits to Certified Investors	<u>\$ 9,991</u>	<u>\$ 9,993</u>
Conversion of note payable to minority interest	<u>\$ 1,000</u>	<u>\$ —</u>
Additions to assets and liabilities as a result of consolidation of acquired interests:		
Cash	\$ 233	\$ —
Accounts receivable	3,579	—
Prepaid expenses and other assets	94	—
Total assets	<u>\$ 3,906</u>	<u>\$ —</u>
Accounts payable and accrued expenses	\$ 3,127	\$ —
Notes payable	3,259	—
Total liabilities	<u>6,386</u>	<u>—</u>
Goodwill recognized	<u>\$ 2,480</u>	<u>\$ —</u>
Reduction of assets and liabilities as a result of deconsolidation of acquired interests:		
Cash	\$ 56	\$ —
Accounts receivable	30	—
Prepaid expenses and other assets	21	—
Fixed assets, net	80	—
Total assets	<u>\$ 187</u>	<u>\$ —</u>
Accounts payable and accrued expenses	\$ 143	\$ —
Deferred revenue	2	—
Notes payable	16	—
Minority interest	26	—
Total liabilities	<u>\$ 187</u>	<u>\$ —</u>

See accompanying notes to these unaudited condensed consolidated financial statements

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

NOTE 1 – DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION:

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

The Company’s principal business segments are:

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

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

SBA Lending: Newtek Small Business Finance, Inc. (“NSBF”), a nationally licensed, U.S. Small Business Administration (“SBA”) lender that originates, sells and services loans to qualifying small businesses, which are partially guaranteed by the SBA.

All Other: Includes results from businesses formed from Investments in Qualified Businesses made through Capco programs which cannot be aggregated with other operating segments.

Corporate Activities: Revenue and expenses not allocated to other segments, including interest income, Capco management fee income and corporate expenses.

Capcos: Fifteen certified capital companies which invest in small and medium-sized businesses. They generate non-cash income from tax credits and non-cash interest and insurance expenses.

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

The accompanying notes to condensed consolidated financial statements should be read in conjunction with Newtek’s 2006 Annual Report on Form 10-K. These financial statements have been prepared in accordance with instructions to Form 10-Q and Article 10 of Regulations S-X and, therefore, omit or condense certain footnotes and other information normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States. The results of operations for an interim period may not give a true indication of the results for the entire year.

All financial information included in the tables in the following footnotes are stated in thousands, except per share data.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES:

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expense during the reporting period. The level of uncertainty in estimates and assumptions increases with the length of time until the underlying transactions are complete. The most significant estimates are with respect to valuation of investments in qualified businesses, asset impairment valuation, allowance for loan losses, valuation of servicing assets, chargeback reserves and tax valuation allowances. Actual results could differ from those estimates.

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Revenue Recognition

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

Electronic payment processing revenue: Electronic payment processing and fee income is derived from the electronic processing of credit and debit card transactions that are authorized and captured through third-party networks. Typically, merchants are charged for these processing services on a percentage of the dollar amount of each transaction plus a flat fee per transaction. Certain merchant customers are charged miscellaneous fees, including fees for handling charge-backs or returns, monthly minimum fees, statement fees and fees for other miscellaneous services. In accordance with Emerging Issues Task Force, (“EITF”) 99-19, “Reporting Revenue Gross as a Principal versus Net as an Agent”, revenues derived from the electronic processing of MasterCard and Visa sourced credit and debit card transactions are reported gross of amounts paid to sponsor banks.

The Company also derives revenues from acting as independent sales offices (“ISO”) for third-party processors (“residual revenue”) and from the sale of credit and debit card devices. Residual revenue is recognized monthly based on contractual agreements with such processors to share in the residual income derived from the underlying merchant agreements. Revenues derived from sales of equipment are recognized at the time of shipment to the merchant.

Income from tax credits: Following an application process, a state will notify a company that it has been certified as a Capco. The state then allocates an aggregate dollar amount of tax credits to the Capco. However, such amount is neither recognized as income nor otherwise recorded in the financial statements since it has yet to be earned by the Capco. The Capco is legally entitled to earn tax credits upon satisfying defined investment percentage thresholds within specified time requirements and corresponding non-recapture percentages. At June 30, 2007, as summarized earlier in this note, the Company had Capcos in seven states and the District of Columbia. Each statute requires that the Capco invest a threshold percentage of Certified Capital in Qualified Businesses within the time frames specified. As the Capco meets these requirements, it avoids grounds under the statute for its disqualification for continued participation in the Capco program. Such a disqualification, or “decertification” as a Capco results in a recapture of all or a portion of the allocated tax credits; the proportion of the recapture is reduced over time as the Capco remains in general compliance with the program rules and meets the progressively increasing investment benchmarks.

As the Capco continues to make its investments in Qualified Businesses and, accordingly, places an increasing proportion of the tax credits beyond recapture, it earns an amount equal to the non-recapturable tax credits and records such amount as “income from tax credits”, with a corresponding asset called “credits in lieu of cash”, in the consolidated balance sheets. The amount earned and recorded as income is determined by multiplying the total amount of tax credits allocated to the Capco by the percentage of tax credits immune from recapture (the earned income percentage) under the state statute. To the extent that the investment requirements are met ahead of schedule, and the percentage of non-recapturable tax credits is accelerated, the present value of the tax credit earned is recognized currently and the asset, credits in lieu of cash, is accreted up to the amount of tax credits available to the Certified Investors. If the tax credits are earned before the state is required to make delivery (i.e., investment requirements are met ahead of schedule, but credits can only be used by the certified investor in a future year), then the present value of the tax credits earned are recorded upon completion of the requirements, in accordance with Accounting Principles Board Opinion No. 21. The receivable (called “credits in lieu of cash”) is accreted to the annual deliverable amount which can then be delivered to the insurance company investors in lieu of cash interest.

The allocation and utilization of Capco tax credits is controlled by the state law. In general, the Capco applies for tax credits from the state and is allocated a specific dollar amount of credits which are available to be earned. The Capco provides the state with a list of the Certified Investors, who have contractually agreed to accept the tax credits in lieu of cash interest payments on their notes. The tax credits are claimed by the Certified Investors on their state premium tax return as provided under each state Capco and tax law. State regulations specify the amount of tax credits a Certified Investor can claim and the period in which they can claim them. Each state periodically reviews the Capco’s operations to verify the amount of tax credits earned. In addition, the state maintains a list of Certified Investors and therefore has the ability to determine whether the Certified Investor is allowed to claim this deduction.

Web Hosting revenue: Web Hosting revenues are primarily derived from monthly recurring services fees for the use of its web hosting and software support services. Customer set-up fees are billed upon service initiation and are recognized as revenue over the estimated customer relationship period of 2.5 years. Payment for web hosting and related services is generally received one month to three years in advance. Deferred revenues represent customer prepayments for upcoming web hosting and related services.

Sales and Servicing of SBA Loans: NSBF originates loans to customers under the SBA program that generally provides for SBA guarantees of 50% to 85% of each loan, subject to a maximum guarantee amount. NSBF sells the guaranteed portion of each loan to a third party and generally retains the unguaranteed principal portion in its own portfolio. A gain is recognized on these loans through collection on sale of a premium over the adjusted carrying value. Commencing on January 1, 2007, gain on sale of the guaranteed portion of the loans is recognized at the date of settlement, under the terms of Statement of Financial Accounting Standards (“SFAS”) No. 156 (“SFAS No. 156”), “Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140” and are recorded as a component of servicing fee and premium income in the condensed consolidated statements of operations. Prior to January 1, 2007, gain on sale of the guaranteed portion of loans was recognized under the provisions of SFAS No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities” a replacement of FASB Statement No. 125.

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In each loan sale, NSBF retains servicing responsibilities and receives servicing fees of a minimum of 1% of the guaranteed loan portion sold. NSBF is required to estimate its servicing compensation in the calculation of its servicing asset. The purchasers of the loans sold have no recourse to NSBF for failure of customers to pay amounts contractually due.

In accordance with SFAS No. 156, upon sale of the loans to third parties, NSBF separately recognizes at fair value any servicing assets or servicing liabilities first, and then allocates the previous carrying amount between the assets sold and the interests that continue to be held by the transferor (the unguaranteed portion of the loan) based on their relative fair values at the date of transfer. The difference between the proceeds received and the allocated carrying value of the financial assets sold is recognized as a gain on sale of loans.

Each class of servicing assets and liabilities are subsequently measured using either the amortization method or the fair value measurement method. The amortization method, which NSBF has chosen to continue applying to its servicing asset, amortizes the asset in proportion to, and over the period of, the estimated future net servicing income on the underlying sold portion of the loans (guaranteed) and assesses the servicing asset for impairment based on fair value at each reporting date. In the event future prepayments are significant or impairments are incurred and future expected cash flows are inadequate to cover the unamortized servicing assets, additional amortization or impairment charges would be recognized. The Company uses an independent valuation specialist to estimate the fair value of the servicing asset.

In evaluating and measuring impairment of servicing assets, NSBF stratifies its servicing assets based on year of loan and loan term which are key risk characteristics of the underlying loan pools. The fair value of servicing assets is determined by calculating the present value of estimated future net servicing cash flows, using assumptions of prepayments, defaults, servicing costs and discount rates that NSBF believes market participants would use for similar assets.

If NSBF determines that the impairment for a stratum is temporary, a valuation allowance is recognized through a charge to current earnings for the amount the unamortized balance exceeds the current fair value. If the fair value of the stratum were to later increase, the valuation allowance may be reduced as a recovery. However, if NSBF determines that an impairment for a stratum is other-than temporary, the value of the servicing asset and any related valuation allowance is written-down.

Interest and Small Business Administration (“SBA”) Loan Fees—SBA Loans: Interest income on loans is recognized as earned. Loans are placed on nonaccrual status if they are 90 days past due with respect to principal or interest and, in the opinion of management, interest or principal on individual loans is not collectible, or at such earlier time as management determines that the collectibility of such principal or interest is unlikely. When a loan is designated as nonaccrual, the accrual of interest is discontinued, and any accrued but uncollected interest income is reversed and charged against current income. While a loan is classified as nonaccrual and the future collectibility of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding.

NSBF passes through to the borrower certain expenditures it incurs, such as forced placed insurance or insufficient funds fees, or fees it assesses, such as late fees, with respect to managing the loan. These expenditures are recorded when incurred. Due to the uncertainty with respect to collection of these passed through expenditures or assessed fees, any funds received to reimburse NSBF are recorded on a cash basis as other income.

Insurance commissions: Revenues are comprised of commissions earned on premiums paid for insurance policies and are recognized at the time the commission is earned. At that date, the earnings process has been completed and the Company can estimate the impact of policy cancellations for refunds and establish reserves. The reserve for policy cancellations is based on historical cancellation experience adjusted by known circumstances.

Other income: Other income represents revenues derived from operating units that cannot be aggregated with other business segments. In addition, other income represents one time recoveries or gains on investments. Revenue is recorded when there is pervasive evidence of an agreement, the related fees are fixed, the service, and or product, has been delivered, and the collection of the related receivable is assured.

Restricted Cash

Restricted cash includes cash collateral relating to a letter of credit; monies due on loan related remittances received by the Company and due to third parties; cash held by the Capcos restricted for use in managing and operating the Capco, making qualified investments and for the payment of income taxes; and a cash account maintained as a reserve against chargeback losses.

Investments

U.S. Treasury Notes and Marketable Securities

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

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

Investments in Qualified Businesses

The various interests that the Company acquires in its qualified investments are accounted for under three methods: consolidation, equity method and cost method. The applicable accounting method is generally determined based on the Company's voting interest or the economics of the transaction if the investee is determined to be a variable interest entity.

Consolidation Method. Investments in which the Company directly or indirectly owns more than 50% of the outstanding voting securities, those the Company has effective control over, or those deemed to be a variable interest entity in which the Company is the primary beneficiary under the provisions of FIN 46R ("FIN 46 consolidated entity") are generally accounted for under the consolidation method of accounting. Under this method, an investment's financial position and results of operations are reflected within the Company's consolidated financial statements. All significant inter-company accounts and transactions are eliminated, including returns of principal, dividends, interest received and investment redemptions. The results of operations and cash flows of a consolidated operating entity are included through the latest interim period in which the Company owned a greater than 50% direct or indirect voting interest, exercised control over the entity for the entire interim period or was otherwise designated as the primary beneficiary. Upon dilution of control below 50%, or upon occurrence of a triggering event requiring reconsideration as to the primary beneficiary of a variable interest entity, the accounting method is adjusted to the equity or cost method of accounting, as appropriate, for subsequent periods.

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

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

The Company's debt and equity investments have substantially been made with funds available to Newtek through the Capco programs. These programs generally require that each Capco meet a minimum investment benchmark within 5 years of initial funding. In addition, any funds received by a Capco as a result of a debt repayment or equity return may, under the terms of the Capco programs, be reinvested and this will be counted towards the Capcos' minimum investment benchmarks.

Stock - Based Compensation

The Company applies SFAS 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"). SFAS 123R requires all share-based payments to employees to be recognized in the financial statements based on their fair values using an option-pricing model at the date of grant.

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

As of June 30, 2007, the Company had two share-based compensation plans. The compensation cost that has been charged against income for those plans was \$52,000 and \$171,000, for the three and six months ended June 30, 2007, respectively, and is included in consulting, payroll and benefits in the accompanying condensed consolidated statements of operations. The total income tax benefit recognized in the consolidated statement of operations for share-based compensation arrangements was \$21,000 and \$68,000, for the three and six months ended June 30, 2007, respectively.

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

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

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

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

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

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

As of June 30, 2007, there was \$149,000 of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized ratably through the year ending December 31, 2009.

Fair value of financial instruments

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

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

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

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

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

- Cash and cash equivalents
- Bank notes payable
- Accrued interest receivable and payable

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

New Accounting Pronouncements

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

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

Based on our evaluation, we have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements. Our evaluation was performed for the tax years ended December 31, 2003, 2004, 2005 and 2006, the tax years which remain subject to examination by major tax jurisdictions as of June 30, 2007.

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

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NOTE 3 – DIVESTITURE:

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

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

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

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

NOTE 4 – SBA LOANS:

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

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

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

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

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

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

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All loans are priced at the prime interest rate plus approximately 2.75% to 3.75%. The only loans with a fixed interest rate are defaulted loans of which the guaranteed portion sold is repurchased from the secondary market by the SBA, while the unguaranteed portion of the loans still remains with the Company. As of June 30, 2007 and December 31, 2006, net SBA loans receivable held for investment with adjustable interest rates amounted to \$25,371,000 and \$26,815,000, respectively.

For the six months ended June 30, 2007 and 2006, the Company funded approximately \$18,821,000 and \$21,675,000 in loans and sold approximately \$13,707,000 and \$14,326,000 of the guaranteed portion of the loans, respectively.

The outstanding balances of loans past due ninety days or more and still accruing interest as of June 30, 2007 and December 31, 2006 amounted to \$49,000 and \$516,000, respectively.

As of June 30, 2007 and December 31, 2006, total impaired non-accrual loans amounted to \$5,661,000 and \$5,293,000, respectively. For the six months ended June 30, 2007 and for the year ended December 31, 2006, the average balance of impaired non-accrual loans was \$5,656,000 and \$4,507,000, respectively. Approximately \$1,508,000 and \$1,036,000, respectively, of the allowance for loan losses were allocated against such impaired nonaccrual loans in accordance with SFAS 114 "Accounting by Creditors for Impairment of a Loan – an amendment of FASB Statement No. 5 and 15". The following is a summary of SBA loans held for investment as of:

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

NOTE 5 – INVESTMENTS IN QUALIFIED BUSINESSES:

HELD TO MATURITY DEBT INVESTMENTS—Summary (In thousands)

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

COST INVESTMENTS—Summary (In thousands)

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

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

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NOTE 6 – SERVICING ASSETS:

Servicing rights are recognized as assets when SBA loans are sold and the rights to service those loans are retained. Through December 31, 2006, the Company recorded its servicing rights at their relative fair values on the date the loans were sold and were carried at the lower of the initial recorded value, adjusted for amortization, or fair value. As of January 1, 2007, the Company adopted the provisions of SFAS No. 156 which requires all separately recognized servicing assets to be initially measured at fair value, if practicable. As of January 1, 2007, the Company identified its entire balance in servicing rights as one class of servicing assets for this measurement. The Company reviews capitalized servicing rights for impairment which is performed based on risk strata, which are determined on a disaggregated basis given the predominant risk characteristics of the underlying loans. The predominant risk characteristics are loan term and year of loan origination.

The changes in the value of the Company's servicing rights for the six months ended June 30, 2007 were as follows:

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

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

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

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

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

(In thousands):	
Cash	\$ 233
Restricted cash	2,050
Accounts receivable, net	3,579
Prepaid expenses and other assets	94
Intangible assets, net	<u>800</u>
Total assets	<u>6,756</u>
Accounts payable and accrued expenses	3,127
Notes payable	6,109
Total liabilities assumed	<u>9,236</u>
Goodwill recognized	<u>\$2,480</u>

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

NOTE 8 – BANK NOTES PAYABLE:

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

NOTE 9 – COMMON STOCK:

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

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

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

NOTE 10 – TREASURY STOCK:

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

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In March 2006, the Newtek Board of Directors adopted a stock buy-back program authorizing management to enter the market to re-purchase up to 1,000,000 of the Company's common shares. During the three months ended June 30, 2007, the Company purchased an additional 12,265 treasury shares under that authorization.

NOTE 11 – EARNINGS (LOSS) PER SHARE:

Basic earnings (loss) per share is computed based on the weighted average number of common shares outstanding during the period. The dilutive effect of common share equivalents is included in the calculation of diluted earnings (loss) per share only when the effect of their inclusion would be dilutive.

The calculations of earnings (loss) per share were:

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

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

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

NOTE 12 – SUBSEQUENT EVENT:

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

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

NOTE 13 – SEGMENT REPORTING:

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

Effective in the fourth quarter of 2005, the Company increased the number of operating segments from four to six. Historically a substantial amount of resources were dedicated to new Capcos and the investment of the proceeds in qualified businesses and the managing of these businesses. Since management does not anticipate any new Capcos in the foreseeable future, the Company has changed its internal reporting to better evaluate and manage the existing Capco business, its corporate activities and its portfolio of small businesses included in the all other segment. The segment previously called Capco and other, which Management previously evaluated as one integrated segment, is now being evaluated as three segments—Capcos, corporate activities and all other. The segment information for prior periods has been restated to conform to the current disclosure.

The SBA lending segment is NSBF, a licensed, U. S. Small Business Administration (SBA) lender that originates, sells and services loans to qualifying small businesses, which are partially guaranteed by the SBA.

As an SBA lender, NSBF generates revenues from sales of loans, servicing income for those loans retained to service by NSBF and interest income earned on the loans themselves. The lender also generates expenses such as interest, professional fees, payroll and consulting, depreciation and amortization, and provision for loan losses, all of which are included in the respective caption on the condensed consolidated statement of operations. NSBF also has expenses such as loan recovery expenses, loan processing costs, and other expenses that are all included in the other general and administrative costs caption on the condensed consolidated statements of operations.

The electronic payment processing segment is a marketer of credit card and check approval services to the small business market. Revenue generated from electronic payment processing is included on the condensed consolidated statements of income as a separate line item. Expenses include direct costs (included in a separate line captioned electronic payment processing direct costs), professional fees, payroll and consulting, and other general and administrative costs, all of which are included in the respective caption on the condensed consolidated statements of operations.

The web hosting segment consists of CrystalTech, acquired in July 2004. CrystalTech’s revenues are derived primarily from web hosting services and set up fees. CrystalTech generates expenses such as professional fees, payroll and consulting, and depreciation and amortization, which are included in the respective caption on the accompanying condensed consolidated statements of operations, as well as licenses and fees, rent, and general office expenses, all of which are included in other general and administrative costs caption in the respective caption on the condensed consolidated statements of operations.

The Capco segment, which consists of the fifteen Capcos, generates non-cash income from tax credits, interest income and gains from investments in qualified businesses which are included in other income. Expenses primarily include non-cash interest and insurance expense, professional fees consisting of management fees paid to Newtek, legal and auditing fees and losses from investments in qualified businesses.

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

Corporate activities represent revenue and expenses not allocated to our segments. Revenue includes interest income and management fees earned from Capcos. Expenses primarily include corporate operations related to broad-based sales and marketing, legal, finance, information technology, corporate development and additional costs associated with administering the Capcos.

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

- the nature of the product and services,
- the type or class of customer for their products and services,
- the methods used to distribute their products or provide their services, and
- the nature of the regulatory environment, for example, banking, insurance, or public utilities.

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

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(In thousands)

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

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Income (loss) before benefit for income taxes and discontinued operations

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

Depreciation and Amortization

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

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

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

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

This Quarterly Report on Form 10-Q contains forward-looking statements. Additional written or oral forward-looking statements may be made by Newtek from time to time in filings with the Securities and Exchange Commission or otherwise. The words "believe," "expect," "seek," and "intend" and similar expressions identify forward-looking statements, which speak only as of the date the statement is made. Such forward-looking statements are within the meaning of that term in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements may include, but are not limited to, projections of income or loss, expenditures, acquisitions, plans for future operations, financing needs or plans relating to our services, as well as assumptions relating to the foregoing. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. Future events and actual results could differ materially from those set forth in, contemplated by or underlying the forward-looking statements.

Newtek does not undertake, and specifically disclaims, any obligation to publicly release the results of revisions which may be made to forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after such statements.

We also need to point out that our Capcos operate under a different set of rules in each of the 8 jurisdictions and that these place varying requirements on the structure of our investments. In some cases, particularly in Louisiana, we don't control the equity or management of a qualified business but that cannot always be presented orally or in written presentations.

We are a direct distributor of business services to the small and medium-sized business market through our wholly and majority owned subsidiaries. Our target market represents a very significant marketplace in the United States gross domestic product or GDP. According to statistics published by the U.S. Small Business Administration, approximately 51% of the GDP in the United States comes from small-to medium-size businesses and 99% of businesses in the United States which have one or more employees fit into this market segment. As of June 30, 2007, we had over 79,000 business accounts. We use state of the art Web-based proprietary technology to be a low cost acquirer and provider of products and services to our small and medium- size business clients. We partner with AIG, Merrill Lynch, Morgan Stanley, UBS, IntegraSys - a Fiserv Company, the Credit Union National Association with its 8,700 credit unions and 80 million members, the Navy Federal Credit Union with 2.7 million members, PSCU Financial Services, Inc., the nation's largest credit union service organization, General Motors Minority Dealers Association and Daimler Chrysler Minority Dealers Association, all of whom have elected to offer certain of our business services and financial products rather than provide some or all of them directly for their customers. We have deemphasized our Capco business in favor of growing our operating businesses and do not anticipate creating any new Capcos in the foreseeable future.

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The Company's reportable business segments are:

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

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

SBA Lending: Newtek Small Business Finance, Inc. ("NSBF"), a nationally licensed, U.S. Small Business Administration ("SBA") lender that originates, sells and services loans to qualifying small businesses, which are partially guaranteed by the SBA.

All Other: Includes results from businesses formed from Investments in Qualified Businesses made through Capco programs which cannot be aggregated with other operating segments.

Corporate Activities: Revenue and expenses not allocated to other segments, including interest income, Capco management fee income and corporate expenses.

Capcos: Fifteen certified capital companies which invest in small and medium-sized businesses. They generate non-cash income from tax credits and non-cash interest and insurance expenses.

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

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

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

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

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

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

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

Changes in interest expense are summarized as follows:

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

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

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

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

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

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

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

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

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

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

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

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

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

(In thousands)	2007	2006	Change
SBA lending	\$1,955	\$1,835	\$ 120
Other interest income	1,083	1,501	(418)
	<u>\$3,038</u>	<u>\$3,336</u>	<u>\$ (298)</u>

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

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

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

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

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

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

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

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

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

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

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

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

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

Electronic Payment Processing

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

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

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

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

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

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

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

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

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Web Hosting

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

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

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

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

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

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

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

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

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

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

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

The \$1,346,000 increase in expenses for the six months ended June 30, 2007 compared to the six months ended June 30, 2006 was primarily due to a \$512,000 increase in consulting, payroll and benefits, a \$383,000 increase in depreciation and amortization, and a \$857,000 increase in other expenses, offset, in part, by a \$324,000 decrease in interest expense due to lower principal outstanding on the TICC debt during 2007. Consulting, payroll and benefits increased due to additional personnel added to service the increased customer base and to extend the hours of operation in customer service. Depreciation and amortization increased due to additional capital expenditures of \$2,174,000 over the past twelve months primarily for additional servers. Other expenses increased primarily due to \$443,000 in additional software licenses required for additional servers, a \$164,000 increase in rent and utilities and a \$60,000 increase in marketing costs.

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SBA Lending

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

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

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

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

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

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

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

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

Expenses decreased by \$71,000 in 2007 compared to 2006, primarily due to a decrease in interest expense, provision for loan loss and professional fees, offset by the write-down of the fair value of Other Real Estate Owned (OREO). Interest expense decreased by \$140,000 as a result of a decrease in the average outstanding balance under the Company's credit facility. The average outstanding balance in the three month period ended June 30, 2007 was \$20,746,000 as compared with \$25,305,000 in the same period in the prior year. Additionally, the fees being charged to the unused portion of the line decreased as a result of the 2nd amendment entered into in December 2006, reducing the overall line from \$75,000,000 to \$50,000,000. The provision for loan loss decreased by \$30,000 as a result of the decrease in the NSBF retained loan receivable balance year over year. Professional fees decreased by \$73,000 due to a reduction in audit and tax expense. As a result of incurring significant costs associated with maintaining its interests in OREO property the Company incurred total write downs of OREO property in the three month period ended June 30, 2007 of \$183,000.

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

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

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

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

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

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

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

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

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

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

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

Capco

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

All Other

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

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

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

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

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

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

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

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

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

Corporate activities

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

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

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

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

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

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

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

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

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

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

A summary of the Company's cash flows provided by (used in) operating activities by segment is as follows:

NEWTEK BUSINESS SERVICES INC. AND SUBSIDIARIES Cash Flows from Operating Activities by Segment For the six months ended June 30, 2007 (In thousands)

Business Services Segments						Total Business Services Segments	CAPCO Segment	Eliminations	Total
Electronic				Corporate					
SBA Lending	Payment Processing	Web Hosting	All Other	Activities					
\$4,924	\$ 25,627	\$7,838	\$ 3,707	\$ 2,232	Net Revenue	\$44,328	\$ 3,356	\$ (2,464)	\$45,220
4,714	23,923	5,815	3,880	6,008	Total Expenses and minority interest	44,340	10,228	(2,464)	52,104
210	1,704	2,023	(173)	(3,776)	Income (loss) before (provision) benefit for income taxes and discontinued operations	(12)	(6,872)	—	(6,884)
—	(519)	(904)	(289)	1,210	(Provision) benefit for income taxes	(502)	2,591	—	2,089
210	1,185	1,119	(462)	(2,566)	Income (loss) before discontinued operations	(514)	(4,281)	—	(4,795)
—	—	—	(491)	—	Discontinued operations, net of taxes	(491)	—	—	(491)
210	1,185	1,119	(953)	(2,566)	Net income (loss)	(1,005)	(4,281)	—	(5,286)
Non-Cash:									
—	—	—	—	—	Income from tax credits	—	(2,621)	—	(2,621)
—	519	763	14	(1,400)	Deferred income taxes	(104)	(2,591)	—	(2,695)
779	890	1,555	159	120	Depreciation and amortization	3,503	28	—	3,531
(504)	—	—	—	—	Capitalization of servicing assets	(504)	—	—	(504)
—	—	—	(1,032)	—	Gain on sale/recoveries of investments in qualified businesses	(1,032)	—	—	(1,032)
—	—	—	—	—	Accretion of interest expense	—	6,082	—	6,082
372	—	—	—	—	Provision for loan losses	372	—	—	372
(93)	—	—	—	—	Gain on sale of loans held for investment	(93)	—	—	(93)
59	—	5	90	257	Other non-cash – net	411	(280)	—	131
Change in assets and liabilities:									
(577)	—	—	—	—	SBA loans originated over proceeds from sale of SBA loans	(577)	—	—	(577)
—	—	—	—	—	Prepaid insurance	—	1,480	—	1,480
(1,757)	—	—	—	—	Restricted cash change	(1,757)	—	—	(1,757)
965	42	(213)	(1,020)	(83)	Other – net	(309)	(191)	—	(500)
<u>\$(546)</u>	<u>\$ 2,636</u>	<u>\$3,229</u>	<u>\$(2,742)</u>	<u>\$ (3,672)</u>	Net cash provided by (used in) operations	<u>\$(1,095)</u>	<u>\$ (2,374)</u>	<u>\$ —</u>	<u>\$ (3,469)</u>

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

Critical Accounting Policies and Estimates:

The Company's significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements included in its Form 10-K for the fiscal year ended December 31, 2006. A discussion of the Company's critical accounting policies, and the related estimates, are included in Management's Discussion and Analysis of Results of Operations and Financial Position in its Form 10-K for the fiscal year ended December 31, 2006. There have been no significant changes in the Company's existing accounting policies or estimates since its fiscal year ended December 31, 2006.

Liquidity and Capital Resources

(Dollars in thousands)

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

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

While Newtek is aware of the changing conditions occurring nationally in the residential real estate market, loans within the portfolio are typically repaid by the business' cash flow and secured by business collateral and personal assets of the business owner and/or guarantors which may include residential real estate as supplemental collateral. Newtek believes its loan loss reserves, which are evaluated monthly on a loan by loan basis, along with its collateral monitoring practices are adequate. We follow the SBA standard operating procedure with respect to obtaining collateral on our loans. This typically includes all business assets and frequently includes personal assets of the owners and/or guarantors.

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

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

Net cash provided by investing activities primarily includes the purchase or sale of fixed assets and customer accounts, activity regarding the unguaranteed portions of SBA loans and changes in restricted cash and investments. During 2007, cash was used to purchase \$1,659,000 in fixed assets primarily to support increased customers in our web hosting segment and to acquire \$166,000 in customer merchant accounts. A net increase in the unguaranteed portion of SBA loans increased cash by \$1,529,000. We also received net proceeds of \$4,066,000 through a reduction in restricted cash held by our Capcos, \$1,370,000 from the return of investments in qualified businesses, \$1,572,000 from the sale of asset held for sale and insurance recoveries, and proceeds of \$492,000 from the sale of an investment in a qualified business.

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

Historically Newtek has funded its operations through the issuance of notes to insurance companies through the Capco programs. We are not anticipating any cash flow from new Capco programs for the foreseeable future. We believe our cash flow generated by our operating companies, available borrowing capacity, existing cash and cash equivalents, and other investments should provide adequate funds for continuing operations and principal and interest payments on our debt.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Because Newtek Small Business Finance, Inc., our SBA lender, borrows money to make loans and investments, our net operating income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. The Company had \$14,740,000 outstanding on the GE line of credit as of June 30, 2007. Interest rates on such notes are variable at prime plus 0.25 or base LIBOR plus 2.50%. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our interest income. In periods of sharply rising interest rates, our cost of funds would increase, which would reduce our net operating income. We have analyzed the potential impact of changes in interest rates on interest income net of interest expense. Assuming that the balance sheet were to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical immediate 1% change in interest rates would have the effect of a net increase (decrease) in assets by less than 1% for the second quarter of 2007. Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet, and other business developments that could effect a net increase (decrease) in assets. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate.

Additionally, we do not have significant exposure to changing interest rates on invested cash and cash equivalents, restricted cash and U.S. Treasury notes which was approximately \$39,931,000 and \$42,976,000 as of June 30, 2007 and December 31, 2006, respectively. The Company invests cash mainly in money market accounts and other investment-grade securities and does not purchase or hold derivative financial instruments for trading purposes.

Item 4. Controls and Procedures.

- (a) **Evaluation of Disclosure Controls and Procedures.** As of the end of the period covered by this report, our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that our disclosure controls and procedures as of the end of the period covered by this report have been designed and are functioning effectively to provide reasonable assurance that the information we (including our consolidated subsidiaries) are required to disclose in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. However, because we had previously determined the existence of a material weakness in our disclosure controls and procedures as of December 31, 2005 and March 31, 2006, and despite the remediation efforts discussed below, and given the relatively short time since the remediation efforts have taken place, there can be no assurance that we have identified and corrected all matters which would constitute, or might lead to future, disclosure control weaknesses.
- (b) **Changes in Internal Controls.** We have placed significant emphasis on remediation of the previously disclosed material weakness and have added a senior legal officer responsible for internal control development and five professional positions in our accounting and finance staff during the quarters ended June 30, 2006, September 30, 2006 and December 31, 2006.
- (c) **Limitations .** A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurances that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that

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judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with its policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. We periodically evaluate our internal controls and make changes to improve them.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 2. Unregistered Sales of Equity Securities

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

(b) In March 2006, the Newtek Board of Directors adopted a stock buy-back program authorizing management to enter the market to re-purchase up to 1,000,000 of the Company's common shares. As of June 30, 2007, the Company purchased 43,765 treasury shares under that authorization.

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

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

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

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

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

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

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

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

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

Item 6. Exhibits

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

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

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NEWTEK BUSINESS SERVICES, INC.

Date: August 14, 2007	By: <u>/s/ Barry Sloane</u> Barry Sloane Chairman of the Board, Chief Executive Officer and Secretary
Date: August 14, 2007	By: <u>/s/ Michael J. Holden</u> Michael J. Holden, Treasurer, Chief Financial Officer, Chief Accounting Officer
Date: August 14, 2007	By: <u>/s/ Eyal Amsalem</u> Eyal Amsalem Chief Accounting Officer and Controller

CREDIT AND SECURITY AGREEMENT

BY AND BETWEEN

CDS BUSINESS SERVICES, INC.

AND

WELLS FARGO BANK, NATIONAL ASSOCIATION

Acting through its Wells Fargo Business Credit operating division

February 27, 2007

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CREDIT AND SECURITY AGREEMENT

Dated as of February 27, 2007

CDS BUSINESS SERVICES, INC., a Delaware corporation (the **"Borrower"**), and **WELLS FARGO BANK, NATIONAL ASSOCIATION** (as more fully defined in Article I herein, the **"Lender"**) acting through its Wells Fargo Business Credit operating division, hereby agree as follows:

Article 1

DEFINITIONS

Section 1.1 Definitions. Except as otherwise expressly provided in this Agreement, the following terms shall have the meanings given them in this Section:

"Accounts" shall have the meaning given it under the UCC, and shall include all Ultimate Debtor Accounts.

"Accounts Advance Rate" means up to eighty-five percent (85%), or such lesser rate as the Lender in its sole discretion may deem appropriate from time to time.

"Advance" means a Revolving Advance.

"Affiliate" or **"Affiliates"** means any Person controlled by, controlling or under common control with the Borrower, including any Subsidiary of the Borrower. For purposes of this definition, "control," when used with respect to any specified Person, means the power to direct the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise.

"Agreement" means this Credit and Security Agreement.

"Availability" means the amount, if any, by which the Borrowing Base exceeds the outstanding principal balance of the Revolving Note.

"Book Net Worth" means the aggregate of the Owners' equity in the Borrower, determined in accordance with GAAP.

"Borrowing Base" means at any time the lesser of:

- (a) The Maximum Line Amount; or
- (b) Subject to change from time to time in the Lender's sole discretion, the sum of:
 - (i) The Accounts Advance Rate times Eligible Accounts; less
 - (ii) The Borrowing Base Reserve, less

(iii) Indebtedness that the Borrower owes to the Lender that has not yet been advanced on the Revolving Note, including, without limitation, the dollar amount that the Lender in its discretion believes is a reasonable determination of the Borrower's credit exposure with respect to any swap, derivative, foreign exchange, hedge, deposit, treasury management or other similar transaction or arrangement offered to Borrower by Lender that is not described in Article II of this Agreement.

"Borrowing Base Reserve" means, as of any date of determination, such amounts (expressed as either a specified amount or as a percentage of a specified category or item) as the Lender may from time to time establish and adjust in reducing Availability (a) to reflect events, conditions, contingencies or risks which, as reasonably determined by the Lender, do or may affect (i) the Collateral or its value, (ii) the assets, business or prospects of the Borrower, or (iii) the security interests and other rights of the Lender in the Collateral (including the enforceability, perfection and priority thereof), or (b) to reflect the Lender's reasonable judgment that any collateral report or financial information furnished by or on behalf of the Borrower to the Lender is or may have been incomplete, inaccurate or misleading in any material respect, or (c) in respect of any state of facts that the Lender reasonably determines constitutes a Default or an Event of Default, and shall include, without limitation, an Availability block of \$100,000. The Borrowing Base Reserve shall be no less than 20% of Ultimate Debtor Accounts.

"Business Day" means a day on which the Federal Reserve Bank of New York is open for business.

"Capital Expenditures" means for a period, any expenditure of money during such period for the lease, purchase or other acquisition of any capital asset, or for the lease of any other asset whether payable currently or in the future.

"Change of Control" means the occurrence of any of the following events:

(a) Any Person or "group" (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934) who is not an Owner on the Funding Date is or becomes the "beneficial owner" (as defined in Rules 13d-3 and 13d-5 under the Securities Exchange Act of 1934, except that a Person will be deemed to have "beneficial ownership" of all securities that such Person has the right to acquire, whether such right is exercisable immediately or only after the passage of time), directly or indirectly, of more than ten percent (10%) of the voting power of all classes of Owners of the Borrower (excluding, however, any change in voting power resulting from the exercise of warrants by Wilshire New York Partners IV, LLC or Wilshire New York Partner V, LLC or from capital contributions made by Exponential of New York, LLC, Wilshire New York Partners IV, LLC or Wilshire New York Partners V, LLC.);

(b) During any consecutive two-year period, individuals who at the beginning of such period constituted the board of Directors of the Borrower (together with any new Directors whose election to such board of Directors, or whose nomination for election by the Owners of the Borrower, was approved by a vote of two thirds of the Directors then still in office who were either Directors at the beginning of such period or whose election or nomination for election was previously so approved) cease for any reason to constitute a majority of the board of Directors of the Borrower then in office; or

(c) Leonard Leff shall cease to actively manage the Borrower's day-to-day business activities and is not replaced with a person satisfactory to Lender within 45 days.

"Collateral" means all of the Borrower's Accounts, chattel paper and electronic chattel paper, deposit accounts, documents, Equipment, General Intangibles, goods, instruments, Inventory, Investment Property, letter-of-credit rights, letters of credit, all sums on deposit in any Collateral Account, and any items in any Lockbox; together with (i) all substitutions and replacements for and products of any of the foregoing; (ii) in the case of all goods, all accessions; (iii) all accessories, attachments, parts, equipment and repairs now or hereafter attached or affixed to or used in connection with any goods; (iv) all warehouse receipts, bills of lading and other documents of title now or hereafter covering such goods; (v) all collateral subject to the Lien of any Security Document; (vi) any money, or other assets of the Borrower that now or hereafter come into the possession, custody, or control of the Lender; (vii) all sums on deposit in the Special Account; (viii) proceeds of any and all of the foregoing; (ix) books and records of the Borrower, including all mail or electronic mail addressed to the Borrower; and (x) all of the foregoing, whether now owned or existing or hereafter acquired or arising or in which the Borrower now has or hereafter acquires any rights.

"Collateral Account" means the "Lender Account" as defined in the Wholesale Lockbox and Collection Account Agreement and, until such "Lender Account" is established, the Collection Accounts as defined and further described in the Deposit Account Control Agreement dated February 15, 2007 by and among Borrower, Lender and Sterling National Bank.

"Commitment" means the Lender's commitment to make Advances to the Borrower.

"Constituent Documents" means with respect to any Person, as applicable, such Person's certificate of incorporation, articles of incorporation, by-laws, certificate of formation, articles of organization, limited liability company agreement, management agreement, operating agreement, shareholder agreement, partnership agreement or similar document or agreement governing such Person's existence, organization or management or concerning disposition of ownership interests of such Person or voting rights among such Person's owners.

"Credit Facility" means the credit facility under which Revolving Advances may be made available to the Borrower by the Lender under Article II.

"Current Maturities of Long Term Debt" means during a period beginning and ending on designated dates, the amount of the Borrower's long-term debt and capitalized leases which become due during that period.

"Cut-off Time" means 11:00 a.m. New York, New York time.

"Debt" means of a Person as of a given date, all items of indebtedness or liability which in accordance with GAAP would be included in determining total liabilities as shown on the liabilities side of a balance sheet for such Person and shall also include the aggregate payments required to be made by such Person at any time under any lease that is considered a capitalized lease under GAAP.

“Default” means an event that, with giving of notice or passage of time or both, would constitute an Event of Default.

“Default Period” means any period of time beginning on the day a Default or Event of Default occurs and ending on the date identified by the Lender in writing as the date that such Default or Event of Default has been cured or waived.

“Default Rate” means an annual interest rate in effect during a Default Period or following the Termination Date, which interest rate shall be equal to three percent (3%) over the applicable Floating Rate, as such rate may change from time to time.

“Dilution” means, as of any date of determination, a percentage, based upon the experience of the trailing six (6) month period ending on the date of determination, which is the result of dividing (a) actual bad debt write-downs, discounts, advertising allowances, credits, or other dilutive items with respect to the Ultimate Debtor Accounts as determined by Lender in its sole discretion during such period, by (b) the Borrower’s net sales during such period (excluding extraordinary items) plus the amount of clause (a).

“Director” means a director if the Borrower is a corporation, a governor or manager if the Borrower is a limited liability company, or a general partner if the Borrower is a partnership.

“Eligible Accounts” means all Ultimate Debtor Accounts purchased by Borrower (but only to the extent Borrower has paid for such Ultimate Debtor Account in full), but excluding any Ultimate Debtor Accounts having any of the following characteristics:

- (i) That portion of Ultimate Debtor Accounts unpaid 90 days or more after the invoice date;
- (ii) That portion of Ultimate Debtor Accounts related to goods or services with respect to which the Borrower has received notice of a claim or dispute, which are subject to a claim of offset or a contra account, or which reflect a reasonable reserve for warranty claims or returns;
- (iii) That portion of Ultimate Debtor Accounts not yet earned by the final delivery of goods or rendition of services, as applicable, by the Borrower to the Ultimate Debtor Customer, including progress billings, and that portion of Ultimate Debtor Accounts for which an invoice has not been sent to the applicable Ultimate Debtor Customer;
- (iv) Ultimate Debtor Accounts constituting (i) proceeds of copyrightable material unless such copyrightable material shall have been registered with the United States Copyright Office, or (ii) proceeds of patentable inventions unless such patentable inventions have been registered with the United States Patent and Trademark Office;

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- (v) Ultimate Debtor Accounts owed by any unit of government, whether foreign or domestic (provided, however, that there shall be included in Eligible Accounts that portion of Accounts owed by such units of government for which the Borrower has provided evidence satisfactory to the Lender that such Ultimate Debtor Accounts may be enforced by the Lender directly against such unit of government under all applicable laws);
- (vi) Ultimate Debtor Accounts denominated in any currency other than United States dollars;
- (vii) Ultimate Debtor Accounts owed by an Ultimate Debtor Customer located outside the United States which are not (A) backed by a bank letter of credit naming the Lender as beneficiary or assigned to the Lender, in the Lender's possession or control, and with respect to which a control agreement concerning the letter-of-credit rights is in effect, and acceptable to the Lender in all respects, in its sole discretion, or (B) covered by a foreign receivables insurance policy acceptable to the Lender in its sole discretion;
- (viii) Ultimate Debtor Accounts owed by an Ultimate Debtor Customer that is insolvent, the subject of bankruptcy proceedings or has gone out of business;
- (ix) all Ultimate Debtor Accounts purchased from an Ultimate Debtor that is insolvent, the subject of bankruptcy proceedings or has gone out of business;
- (x) Ultimate Debtor Accounts owed by an Owner, Subsidiary, Affiliate, Officer or employee of the Borrower;
- (xi) Ultimate Debtor Accounts which are subject to any Lien in favor of any Person other than the Lender;
- (xii) That portion of Ultimate Debtor Accounts that has been restructured, extended, amended or modified;
- (xiii) That portion of Ultimate Debtor Accounts that constitutes advertising, finance charges, or service charges;
- (xiv) Ultimate Debtor Accounts purchased from an Ultimate Debtor, regardless of whether otherwise eligible (A) to the extent that the aggregate balance of such Ultimate Debtor Accounts exceeds twenty percent (20%) of the aggregate amount of all Eligible Accounts and (B) in the case of each Ultimate Debtor, to the extent that the Ultimate Debtor Accounts owed by any Ultimate Debtor Customer exceeds twenty percent (20%) of the aggregate amount of all Ultimate Debtor Accounts of such Ultimate Debtor;
- (xv) Ultimate Debtor Accounts purchased from an Ultimate Debtor, regardless of whether otherwise eligible, if twenty-five percent (25%) or more of the total amount of Ultimate Debtor Accounts of such Ultimate Debtor is ineligible under clauses (i), (ii), or (x) above; and

(xvi) Ultimate Debtor Accounts, or portions thereof, otherwise deemed ineligible by the Lender in its reasonable discretion.

“ERISA” means the Employee Retirement Income Security Act of 1974, as amended from time to time.

“ERISA Affiliate” means any trade or business (whether or not incorporated) that is a member of a group which includes the Borrower and which is treated as a single employer under Section 414 of the IRC.

“Environmental Law” means any federal, state, local or other governmental statute, regulation, law or ordinance dealing with the protection of human health and the environment.

“Equipment” shall have the meaning given it under the UCC.

“Event of Default” is defined in Section 7.1.

“Financial Covenants” means the covenants set forth in Section 6.2.

“Floating Rate” means an annual interest rate equal to the sum of the Prime Rate plus two percent (2%), which interest rate shall change when and as the Prime Rate changes.

“Floating Rate Advance” means an Advance bearing interest at the Floating Rate.

“Funding Date” is defined in Section 2.1.

“GAAP” means generally accepted accounting principles, applied on a basis consistent with the accounting practices applied in the financial statements described in Section 5.6.

“General Intangibles” shall have the meaning given it under the UCC.

“Guarantor” means Leonard Leff and every other Person now or in the future who agrees to guaranty the Indebtedness.

“Guaranty” means each unconditional continuing guaranty executed by a Guarantor in favor of the Lender.

“Hazardous Substances” means pollutants, contaminants, hazardous substances, hazardous wastes, petroleum and fractions thereof, and all other chemicals, wastes, substances and materials listed in, regulated by or identified in any Environmental Law.

“Indebtedness” is used herein in its most comprehensive sense and means any and all advances, debts, obligations and liabilities of the Borrower to the Lender, heretofore, now or hereafter made, incurred or created, whether voluntary or involuntary and however arising, whether due or not due, absolute or contingent, liquidated or unliquidated, determined or undetermined, including under any swap, derivative, foreign exchange, hedge, deposit, treasury management or other similar transaction or arrangement at any time entered into by the Borrower

with the Lender, and whether the Borrower may be liable individually or jointly with others, or whether recovery upon such Indebtedness may be or hereafter becomes unenforceable.

“Indemnified Liabilities” is defined in Section 8.6

“Indemnitees” is defined in Section 8.6.

“IRC” means the Internal Revenue Code of 1986, as amended from time to time.

“Infringement” or **“Infringing”** when used with respect to Intellectual Property Rights means any infringement or other violation of Intellectual Property Rights.

“Intellectual Property Rights” means all actual or prospective rights arising in connection with any intellectual property or other proprietary rights, including all rights arising in connection with copyrights, patents, service marks, trade dress, trade secrets, trademarks, trade names or mask works.

“Interest Payment Date” is defined in Section 2.8(a).

“Inventory” shall have the meaning given it under the UCC.

“Investment Property” shall have the meaning given it under the UCC.

“Lender” means Wells Fargo Bank, National Association in its broadest and most comprehensive sense as a legal entity, and is not limited in its meaning to Lender’s Wells Fargo Business Credit operating division, or to any other operating division of Lender.

“Licensed Intellectual Property” is defined in Section 5.11(c).

“Lien” means any security interest, mortgage, deed of trust, pledge, lien, charge, encumbrance, title retention agreement or analogous instrument or device, including the interest of each lessor under any capitalized lease and the interest of any bondsman under any payment or performance bond, in, of or on any assets or properties of a Person, whether now owned or subsequently acquired and whether arising by agreement or operation of law.

“Loan Documents” means this Agreement, the Revolving Note, each Guaranty, each Subordination Agreement, and the Security Documents, together with every other agreement, note, document, contract or instrument to which the Borrower now or in the future may be a party and which is required by the Lender.

“Lockbox” means “Lockbox” as defined in the Wholesale Lockbox and Collection Account Agreement or, until such “Lockbox” is established, the Lockbox as defined and further described in the Deposit Account Control Agreement dated February 27, 2007 by and among Borrower, Lender and Sterling National Bank.

“Material Adverse Effect” means any of the following:

(i) A material adverse effect on the business, operations, results of operations, prospects, assets, liabilities or financial condition of the Borrower;

(ii) A material adverse effect on the ability of the Borrower to perform its obligations under the Loan Documents;

(iii) A material adverse effect on the ability of the Lender to enforce the Indebtedness or to realize the intended benefits of the Security Documents, including a material adverse effect on the validity or enforceability of any Loan Document or of any rights against any Guarantor, or on the status, existence, perfection, priority (subject to Permitted Liens) or enforceability of any Lien securing payment or performance of the Indebtedness; or

(iv) Any claim against the Borrower or threat of litigation which if determined adversely to the Borrower would cause the Borrower to be liable to pay an amount exceeding \$50,000 or would result in the occurrence of an event described in clauses (i), (ii) and (iii) above.

“Maturity Date” means February 27, 2009.

“Maximum Line Amount” means \$10,000,000 unless this amount is reduced pursuant to Section 2.10, in which event it means such lower amount.

“Multiemployer Plan” means a multiemployer plan (as defined in Section 4001 (a)(3) of ERISA) to which the Borrower or any ERISA Affiliate contributes or is obligated to contribute.

“Net Cash Flow” means (a) Net Income (Loss) plus depreciation and amortization and accrued but not paid interest on subordinated debt, less (b) the sum of (i) unfinanced Capital Expenditures, (ii) Current Maturities of Long Term Debt and Capital Leases, and (iii) dividends and distributions paid by the Borrower.

“Net Cash Proceeds” means in connection with any asset sale, the cash proceeds (including any cash payments received by way of deferred payment whether pursuant to a note, installment receivable or otherwise, but only as and when actually received) from such asset sale, net of (i) attorneys’ fees, accountants’ fees, investment banking fees, brokerage commissions and amounts required to be applied to the repayment of any portion of the Debt secured by a Lien not prohibited hereunder on the asset which is the subject of such sale, and (ii) taxes paid or reasonably estimated to be payable as a result of such asset sale.

“Net Income” means fiscal year-to-date after-tax net income from continuing operations, including extraordinary losses but excluding extraordinary gains, all as determined in accordance with GAAP.

“Net Loss” means fiscal year-to-date after-tax net loss from continuing operations as determined in accordance with GAAP.

“Officer” means with respect to the Borrower, an officer if the Borrower is a corporation, a manager if the Borrower is a limited liability company, or a partner if the Borrower is a partnership.

“OFAC” is defined in Section 6.12(c).

“Overadvance” means the amount, if any, by which the outstanding principal balance of the Revolving Note is in excess of the then-existing Borrowing Base.

“Owned Intellectual Property” is defined in Section 5.11 (a).

“Owner” means with respect to the Borrower, each Person having legal or beneficial title to an ownership interest in the Borrower or a right to acquire such an interest.

“Pension Plan” means a pension plan (as defined in Section 3(2) of ERISA) maintained for employees of the Borrower or any ERISA Affiliate and covered by Title IV of ERISA.

“Permitted Lien” and **“Permitted Liens”** are defined in Section 6.3(a).

“Person” means any individual, corporation, partnership, joint venture, limited liability company, association, joint-stock company, trust, unincorporated organization or government or any agency or political subdivision thereof.

“Plan” means, if applicable, an employee benefit plan (as defined in Section 3(3) of ERISA) maintained for employees of the Borrower or any ERISA Affiliate.

“Premises” means all locations where the Borrower conducts its business or has any rights of possession, including the locations legally described in **Exhibit C** attached hereto.

“Prime Rate” means at any time the rate of interest most recently announced by the Lender at its principal office as its Prime Rate, with the understanding that the Prime Rate is one of the Lender’s base rates, and serves as the basis upon which effective rates of interest are calculated for those loans making reference thereto, and is evidenced by the recording thereof in such internal publication or publications as the Lender may designate. Each change in the rate of interest shall become effective on the date each Prime Rate change is announced by the Lender.

“Reportable Event” means a reportable event (as defined in Section 4043 of ERISA), other than an event for which the 30-day notice requirement under ERISA has been waived in regulations issued by the Pension Benefit Guaranty Corporation.

“Revolving Advance” is defined in Section 2.1.

“Revolving Note” means the Borrower’s revolving promissory note, payable to the order of the Lender in substantially the form of Exhibit A hereto, as same may be renewed and amended from time to time, and all replacements thereto.

“Security Documents” means this Agreement, the Wholesale Lockbox and Collection Account Agreement, and any other document delivered to the Lender from time to time to secure the Indebtedness.

“Security Interest” is defined in Section 3.1.

“Subordinated Creditors” means Newtek Business Services, Inc., Wilshire New York Partners IV, LLC, Wilshire New York Partners V, LLC, Exponential of New York, LLC and every other Person now or in the future who agrees to subordinate indebtedness of the Borrower held by that Person to the payment of the Indebtedness.

“Subordination Agreement” means a subordination agreement executed by a Subordinated Creditor in favor of the Lender and acknowledged by the Borrower.

“Subsidiary” means any Person of which more than fifty percent (50%) of the outstanding ownership interests having general voting power under ordinary circumstances to elect a majority of the board of directors or the equivalent of such Person, regardless of whether or not at the time ownership interests of any other class or classes shall have or might have voting power by reason of the happening of any contingency, is at the time directly or indirectly owned by the Borrower, by the Borrower and one or more other Subsidiaries, or by one or more other Subsidiaries.

“Tangible Net Worth” means the sum of (i) Book Net Worth plus Subordinated Debt less the sum of (i) due from Affiliates and (ii) other intangible assets, as defined by GAAP (but shall exclude deferred financing costs).

“Termination Date” means the earliest of (i) the Maturity Date, (ii) the date the Borrower terminates the Credit Facility, or (iii) the date the Lender demands payment of the Indebtedness, following an Event of Default, pursuant to Section 7.2.

“UCC” means the Uniform Commercial Code in effect in the state designated in this Agreement as the state whose laws shall govern this Agreement, or in any other state whose laws are held to govern this Agreement or any portion of this Agreement.

“Ultimate Debtor” means any client of Borrower from whom Borrower has purchased such Ultimate Debtor’s accounts receivable in connection with a factoring arrangement between Borrower and Ultimate Debtor.

“Ultimate Debtor Accounts” means the accounts receivable of an Ultimate Debtor that are purchased by Borrower.

“Ultimate Debtor Customer” means the customer of an Ultimate Debtor obligated to the Ultimate Debtor on an Ultimate Debtor Account.

“Unused Amount” is defined in Section 2.7(b).

“Wholesale Lockbox and Collection Account Agreement” means the Wholesale Lockbox and Collection Account Agreement by and between the Borrower and the Lender.

Section 1.2 Other Definitional Terms; Rules of Interpretation. The words “hereof”, “herein” and “hereunder” and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement. All accounting terms not otherwise defined herein have the meanings assigned to them in accordance with GAAP. All terms defined in the UCC and not otherwise defined herein have the meanings assigned to them in the UCC. References to Articles, Sections, subsections, Exhibits, Schedules and the like, are to Articles, Sections and subsections of, or Exhibits or Schedules attached to, this Agreement unless otherwise expressly provided. The words “include”, “includes” and “including” shall be deemed to be followed by the phrase “without limitation”. Unless the context in which used herein otherwise clearly requires, “or” has the inclusive meaning represented by the phrase “and/or”. Defined terms include in the singular number the plural and in the plural number the singular. Reference to any agreement (including the Loan Documents), document or instrument means such agreement, document or instrument as amended or modified and in effect from time to time in accordance with the terms thereof (and, if applicable, in accordance with the terms hereof and the other Loan Documents), except where otherwise explicitly provided, and reference to any promissory note includes any promissory note which is an extension or renewal thereof or a substitute or replacement therefor. Reference to any law, rule, regulation, order, decree, requirement, policy, guideline, directive or interpretation means as amended, modified, codified, replaced or reenacted, in whole or in part, and in effect on the determination date, including rules and regulations promulgated thereunder.

Article 2

AMOUNT AND TERMS OF THE CREDIT FACILITY

Section 2.1 Revolving Advances. The Lender agrees, subject to the terms and conditions of this Agreement, to make advances (“**Revolving Advances**”) to the Borrower from time to time from the date that all of the conditions set forth in 4.1 are satisfied (the “**Funding Date**”) to and until (but not including) the Termination Date in an amount not in excess of the Maximum Line Amount. The Lender shall have no obligation to make a Revolving Advance to the extent that the amount of the requested Revolving Advance exceeds Availability. The Borrower’s obligation to pay the Revolving Advances shall be evidenced by the Revolving Note and shall be secured by the Collateral. Within the limits set forth in this Section 2.1, the Borrower may borrow, prepay pursuant to Section 2.10, and reborrow.

Section 2.2 Procedures for Requesting Advances. The Borrower shall comply with the following procedures in requesting Revolving Advances:

(a) **Type of Advances**. Each Advance shall be funded as a Floating Rate Advance.

(b) **Time for Requests**. The Borrower shall request each Advance not later than the Cut-off Time on the Business Day immediately preceding the Business Day on which the Advance is to be made. Each request that conforms to the terms of this Agreement shall be effective upon receipt by the Lender, shall be in writing or by telephone or telecopy transmission, and shall be confirmed in writing by the Borrower if so requested by the Lender, by (i) an Officer of the Borrower; or (ii) a Person designated as the Borrower’s agent by an

Officer of the Borrower in a writing delivered to the Lender; or (iii) a Person whom the Lender reasonably believes to be an Officer of the Borrower or such a designated agent. The Borrower shall repay all Advances even if the Lender does not receive such confirmation and even if the Person requesting an Advance was not in fact authorized to do so. Any request for an Advance, whether written or telephonic, shall be deemed to be a representation by the Borrower that the conditions set forth in Section 4.2 have been satisfied as of the time of the request.

(c) **Disbursement** . Upon fulfillment of the applicable conditions set forth in Article IV, the Lender shall disburse the proceeds of the requested Advance by crediting the same to the Borrower's demand deposit account maintained with the Lender unless the Lender and the Borrower shall agree in writing to another manner of disbursement.

Section 2.3 **Intentionally Omitted** .

Section 2.4 **Intentionally Omitted** .

Section 2.5 **Intentionally Omitted** .

Section 2.6 Interest; Default Interest Rate; Application of Payments; Participations; Usury .

(a) **Interest** . Except as provided in Section 2.6(d) and Section 2.6(g), the principal amount of each Advance shall bear interest as a Floating Rate Advance.

(b) **Intentionally Omitted** .

(c) **Minimum Interest Charge** . In the event the average closing daily unpaid balances of all Revolving Advances (excluding any Overadvance) hereunder during any calendar month is less than \$2,000,000, the Borrower shall pay the Lender a minimum loan fee at a rate per annum equal to the Floating Rate on the amount by which \$2,000,000 exceeds such daily unpaid balances. Such fee shall be charged to the Borrower's account on the first day of each month with respect to the prior month.

(d) **Default Interest Rate** . At any time during any Default Period or following the Termination Date, in the Lender's sole discretion and without waiving any of its other rights or remedies, the principal of the Revolving Note shall bear interest at the Default Rate or such lesser rate as the Lender may determine, effective as of the first day of the month in which any Default Period begins through the last day of such Default Period, or any shorter time period that the Lender may determine. The decision of the Lender to impose a rate that is less than the Default Rate or to not impose the Default Rate for the entire duration of the Default Period shall be made by the Lender in its sole discretion and shall not be a waiver of any of its other rights and remedies, including its right to retroactively impose the full Default Rate for the entirety of any such Default Period or following the Termination Date.

(e) **Application of Payments** . Payments shall be applied to the Indebtedness on the Business Day of receipt by the Lender in the Lender's general account, but the amount of principal paid shall continue to accrue interest at the interest rate applicable under the terms of

this Agreement from the calendar day the Lender receives the payment, and continuing through the end of the second Business Day following receipt of the payment.

(f) **Participations.** If any Person shall acquire a participation in the Advances or the Obligation of Reimbursement, the Borrower shall be obligated to the Lender to pay the full amount of all interest calculated under this Section 2.6, along with all other fees, charges and other amounts due under this Agreement, regardless if such Person elects to accept interest with respect to its participation at a lower rate than that calculated under this Section 2.6, or otherwise elects to accept less than its prorata share of such fees, charges and other amounts due under this Agreement.

(g) **Usury.** In any event no rate change shall be put into effect which would result in a rate greater than the highest rate permitted by law. Notwithstanding anything to the contrary contained in any Loan Document, all agreements which either now are or which shall become agreements between the Borrower and the Lender are hereby limited so that in no contingency or event whatsoever shall the total liability for payments in the nature of interest, additional interest and other charges exceed the applicable limits imposed by any applicable usury laws. If any payments in the nature of interest, additional interest and other charges made under any Loan Document are held to be in excess of the limits imposed by any applicable usury laws, it is agreed that any such amount held to be in excess shall be considered payment of principal hereunder, and the indebtedness evidenced hereby shall be reduced by such amount so that the total liability for payments in the nature of interest, additional interest and other charges shall not exceed the applicable limits imposed by any applicable usury laws, in compliance with the desires of the Borrower and the Lender. This provision shall never be superseded or waived and shall control every other provision of the Loan Documents and all agreements between the Borrower and the Lender, or their successors and assigns.

Section 2.7 Fees.

(a) **Origination Fee.** The Borrower shall pay the Lender a fully earned and non- refundable origination fee of \$75,000, due and payable in three (3) equal monthly installments, the first due upon the execution of this Agreement, the second due 30 days after the execution of this Agreement and the third due 60 days after the execution of this Agreement.

(b) **Unused Line Fee.** For the purposes of this Section 2.7(b), “**Unused Amount**” means the Maximum Line Amount reduced by outstanding Revolving Advances. The Borrower agrees to pay to the Lender an unused line fee at the rate of one-quarter of one percent (0.25%) per annum on the average daily Unused Amount from the date of this Agreement to and including the Termination Date, due and payable monthly in arrears on the first day of the month and on the Termination Date.

(c) **Monthly Monitoring Fee.** The Borrower agrees to pay to the Lender a monthly monitoring fee in the amount of \$250 per month, due and payable monthly in arrears on the first day of each month and on the Termination Date.

(d) Collateral Exam Fees.

(i) The Borrower shall pay the Lender fees in connection with any collateral exams, audits or inspections conducted by or on behalf of the Lender of any Collateral or the Borrower's operations or business at the rates established from time to time by the Lender as its collateral exam fees (which fees are currently \$950 per day per collateral examiner) together with all actual out-of-pocket costs and expenses incurred in conducting any such collateral examination or inspection. Notwithstanding the foregoing, Lender agrees that, so long as no Default has occurred, Borrower shall not be required to pay for more than four (4) such exams during the first year following the Funding Date.

(ii) The Lender may, from time to time, engage a third party to calculate ineligible collateral for the purposes of the Borrowing Base and to perform certain other collateral monitoring services. The Lender currently utilizes Collateral Services, Inc. for such purpose. The Borrower shall pay the Lender an initial set-up fee of \$1000 for such service and shall, in addition, pay the Lender a monthly fee at the rates established from time to time by Collateral Services, Inc. to cover the cost thereof (which fees are currently \$100.)

(e) Termination and Line Reduction Fees. If (i) the Lender terminates the Credit Facility during a Default Period, or if (ii) the Borrower terminates or reduces the Credit Facility on a date prior to the Maturity Date, then the Borrower shall pay the Lender as liquidated damages and not as a penalty a termination fee in an amount equal to a percentage of the Maximum Line Amount (or the reduction of the Maximum Line Amount, as the case may be) calculated as follows: (A) three percent (3%) if the termination or reduction occurs on or before the first anniversary of the Funding Date; and (B) one percent (1%) if the termination or reduction occurs after the first anniversary of the Funding Date, but on or before the second anniversary of the Funding Date.

(f) Overadvance Fees. The Borrower shall pay an Overadvance fee in the amount of \$500.00 for each day or portion thereof during which an Overadvance exists, regardless of how the Overadvance arises or whether or not the Overadvance has been agreed to in advance by the Lender. The acceptance of payment of an Overadvance fee by the Lender shall not be deemed to constitute either consent to the Overadvance or a waiver of the resulting Event of Default, unless the Lender specifically consents to the Overadvance in writing and waives the Event of Default on whatever conditions the Lender deems appropriate.

(g) Other Fees and Charges. The Lender may from time to time impose additional fees and charges as consideration for Advances made in excess of Availability or for other events that constitute an Event of Default or a Default hereunder, including fees and charges for the administration of Collateral by the Lender, and fees and charges for the late delivery of reports, which may be assessed in the Lender's sole discretion on either an hourly, periodic, or flat fee basis, and in lieu of or in addition to imposing interest at the Default Rate.

Section 2.8 Time for Interest Payments; Payment on Non-Business Days; Computation of Interest and Fees.

(a) Time For Interest Payments. Accrued and unpaid interest shall be due and payable on the first day of each month and on the Termination Date (each an "**Interest Payment Date**"), or if any such day is not a Business Day, on the next succeeding Business

Day. Interest will accrue from the most recent date to which interest has been paid or, if no interest has been paid, from the date of advance to the Interest Payment Date. If an Interest Payment Date is not a Business Day, payment shall be made on the next succeeding Business Day.

(b) **Payment on Non-Business Days.** Whenever any payment to be made hereunder shall be stated to be due on a day which is not a Business Day, such payment may be made on the next succeeding Business Day, and such extension of time shall in such case be included in the computation of interest on the Advances or the fees hereunder, as the case may be.

(c) **Computation of Interest and Fees.** Interest accruing on the outstanding principal balance of the Advances and fees hereunder outstanding from time to time shall be computed on the basis of actual number of days elapsed in a year of 360 days.

Section 2.9 Lockbox and Collateral Account; Sweep of Funds.

(a) **Lockbox and Collateral Account.**

(i) The Borrower shall instruct all account debtors to pay all Accounts directly to the Lockbox. If, notwithstanding such instructions, the Borrower receives any payments on Accounts, the Borrower shall deposit such payments into the Collateral Account. The Borrower shall also deposit all other cash proceeds of Collateral regardless of source or nature directly into the Collateral Account. Until so deposited, the Borrower shall hold all such payments and cash proceeds in trust for and as the property of the Lender and shall not commingle such property with any of its other funds or property. All deposits in the Collateral Account shall constitute proceeds of Collateral and shall not constitute payment of the Indebtedness.

(ii) All items deposited in the Collateral Account shall be subject to final payment. If any such item is returned uncollected, the Borrower will immediately pay the Lender, or, for items deposited in the Collateral Account, the bank maintaining such account, the amount of that item, or such bank at its discretion may charge any uncollected item to the Borrower's commercial account or other account. The Borrower shall be liable as an endorser on all items deposited in the Collateral Account, whether or not in fact endorsed by the Borrower.

(b) **Sweep of Funds.** The Lender shall from time to time, in accordance with the Wholesale Lockbox and Collection Account Agreement, cause funds in the Collateral Account to be transferred to the Lender's general account for payment of the Indebtedness. Amounts deposited in the Collateral Account shall not be subject to withdrawal by the Borrower, except after payment in full and discharge of all Indebtedness.

Section 2.10 Voluntary Prepayment; Termination of the Credit Facility by the Borrower. Except as otherwise provided herein, the Borrower may prepay the Advances in whole at any time or from time to time in part. The Borrower may terminate the Credit Facility at any time if it (i) gives the Lender at least 90 days advance written notice prior to the proposed Termination Date, and (ii) pays the Lender applicable termination, prepayment and contracted

funds breakage fees in accordance with the terms of this Agreement. If the Borrower terminates the Credit Facility, all Indebtedness shall be immediately due and payable, and if the Borrower gives the Lender less than the required 90 days advance written notice, then the interest rate applicable to borrowings evidenced by the Revolving Note shall be the Default Rate for the period of time commencing 90 days prior to the proposed Termination Date through the date that the Lender actually receives such written notice. If the Borrower does not wish the Lender to consider renewal of the Credit Facility on the next Maturity Date, then the Borrower shall give the Lender at least 90 days written notice prior to the Maturity Date that it will not be requesting renewal. If the Borrower fails to give the Lender such timely notice, then the interest rate applicable to borrowings evidenced by the Revolving Note shall be the Default Rate for the period of time commencing 90 days prior to the Maturity Date through the date that the Lender actually receives such written notice.

Section 2.11 Mandatory Prepayment. Without notice or demand, if the sum of the outstanding principal balance of the Revolving Advances shall at any time exceed the Borrowing Base, the Borrower shall (i) first, immediately prepay the Revolving Advances to the extent necessary to eliminate such excess; and (ii) if prepayment in full of the Revolving Advances is insufficient to eliminate such excess, pay to the Lender in immediately available funds an amount equal to the remaining excess. Any voluntary or mandatory prepayment received by the Lender may be applied to the Indebtedness, in such order and in such amounts as the Lender in its sole discretion may determine from time to time.

Section 2.12 Revolving Advances to Pay Indebtedness. Notwithstanding the terms of Section 2.1, the Lender may, in its discretion at any time or from time to time, without the Borrower's request and even if the conditions set forth in Section 4.2 would not be satisfied, make a Revolving Advance in an amount equal to the portion of the Indebtedness from time to time due and payable.

Section 2.13 Use of Proceeds. The Borrower shall use the proceeds of Advances to repay indebtedness to Exponential of New York, LLC and for ordinary working capital purposes.

Section 2.14 Liability Records. The Lender may maintain from time to time, at its discretion, records as to the Indebtedness. All entries made on any such record shall be presumed correct until the Borrower establishes the contrary. Upon the Lender's demand, the Borrower will admit and certify in writing the exact principal balance of the Indebtedness that the Borrower then asserts to be outstanding. Any billing statement or accounting rendered by the Lender shall be conclusive and fully binding on the Borrower unless the Borrower gives the Lender specific written notice of exception within 30 days after receipt.

Article 3

SECURITY INTEREST; OCCUPANCY; SETOFF

Section 3.1 Grant of Security Interest. The Borrower hereby pledges, assigns and grants to the Lender, a lien and security interest (collectively referred to as the "**Security Interest**") in the Collateral, as security for the payment and performance of: (a) all present and future Indebtedness of the Borrower to the Lender; (b) all obligations of the Borrower and rights

of the Lender under this Agreement; and (c) all present and future obligations of the Borrower to the Lender of other kinds. Upon request by the Lender, the Borrower will grant to the Lender a security interest in all commercial tort claims that the Borrower may have against any Person.

Section 3.2 Notification of Account Debtors and Other Obligors. The Lender may at any time (whether or not a Default Period then exists) notify any account debtor (including, without limitation, any Ultimate Debtor Customer) or other Person obligated to pay the amount due that such right to payment has been assigned or transferred to the Lender for security and shall be paid directly to the Lender. The Borrower will join in giving such notice if the Lender so requests. At any time after the Borrower or the Lender gives such notice to an account debtor or other obligor, the Lender may, but need not, in the Lender's name or in the Borrower's name, demand, sue for, collect or receive any money or property at any time payable or receivable on account of, or securing, any such right to payment, or grant any extension to, make any compromise or settlement with or otherwise agree to waive, modify, amend or change the obligations (including collateral obligations) of any such account debtor or other obligor. The Lender may, in the Lender's name or in the Borrower's name, as the Borrower's agent and attorney-in-fact, notify the United States Postal Service to change the address for delivery of the Borrower's mail to any address designated by the Lender, otherwise intercept the Borrower's mail, and receive, open and dispose of the Borrower's mail, applying all Collateral as permitted under this Agreement and holding all other mail for the Borrower's account or forwarding such mail to the Borrower's last known address.

Section 3.3 Assignment of Insurance. As additional security for the payment and performance of the Indebtedness, the Borrower hereby assigns to the Lender any and all monies (including proceeds of insurance and refunds of unearned premiums) due or to become due under, and all other rights of the Borrower with respect to, any and all policies of insurance now or at any time hereafter covering the Collateral or any evidence thereof or any business records or valuable papers pertaining thereto, and the Borrower hereby directs the issuer of any such policy to pay all such monies directly to the Lender. At any time, whether or not a Default Period then exists, the Lender may (but need not), in the Lender's name or in the Borrower's name, execute and deliver proof of claim, receive all such monies, endorse checks and other instruments representing payment of such monies, and adjust, litigate, compromise or release any claim against the issuer of any such policy. Any monies received as payment for any loss under any insurance policy mentioned above (other than liability insurance policies) or as payment of any award or compensation for condemnation or taking by eminent domain, shall be paid over to the Lender to be applied, at the option of the Lender, either to the prepayment of the Indebtedness or shall be disbursed to the Borrower under staged payment terms reasonably satisfactory to the Lender for application to the cost of repairs, replacements, or restorations. Any such repairs, replacements, or restorations shall be effected with reasonable promptness and shall be of a value at least equal to the value of the items or property destroyed prior to such damage or destruction.

Section 3.4 Occupancy.

(a) The Borrower hereby irrevocably grants to the Lender the right to take exclusive possession of the Premises at any time during a Default Period without notice or consent.

(b) The Lender may use the Premises only to hold, process, manufacture, sell, use, store, liquidate, realize upon or otherwise dispose of goods that are Collateral and for other purposes that the Lender may in good faith deem to be related or incidental purposes.

(c) The Lender's right to hold the Premises shall cease and terminate upon the earlier of (i) payment in full and discharge of all Indebtedness and termination of the Credit Facility, and (ii) final sale or disposition of all goods constituting Collateral and delivery of all such goods to purchasers.

(d) The Lender shall not be obligated to pay or account for any rent or other compensation for the possession, occupancy or use of any of the Premises; provided, however, that if the Lender does pay or account for any rent or other compensation for the possession, occupancy or use of any of the Premises, the Borrower shall reimburse the Lender promptly for the full amount thereof. In addition, the Borrower will pay, or reimburse the Lender for, all taxes, fees, duties, imposts, charges and expenses at any time incurred by or imposed upon the Lender by reason of the execution, delivery, existence, recordation, performance or enforcement of this Agreement or the provisions of this Section 3.4.

Section 3.5 License. Without limiting the generality of any other Security Document, the Borrower hereby grants to the Lender a non-exclusive, worldwide and royalty-free license to use or otherwise exploit all Intellectual Property Rights of the Borrower for the purpose of selling, leasing or otherwise disposing of any or all Collateral during any Default Period.

Section 3.6 Financing Statement. The Borrower authorizes the Lender to file from time to time, such financing statements against collateral described as "all personal property" or "all assets" or describing specific items of collateral including commercial tort claims as the Lender deems necessary or useful to perfect the Security Interest. All financing statements filed before the date hereof to perfect the Security Interest were authorized by the Borrower and are hereby re-authorized. A carbon, photographic or other reproduction of this Agreement or of any financing statements signed by the Borrower is sufficient as a financing statement and may be filed as a financing statement in any state to perfect the security interests granted hereby. For this purpose, the Borrower represents and warrants that the following information is true and correct:

Name and address of Debtor:

CDS Business Services, Inc.
60 Hempstead Ave., 6th Floor
West Hempstead, NY 11552
Federal Employer Identification No. 20-1413049
Organizational Identification No. 3827143

Name and address of Secured Party:

Wells Fargo Bank, National Association
119 West 40th Street, 16th Floor
New York, New York 10018-2500

Section 3.7 Setoff. The Lender may at any time or from time to time, at its sole discretion and without demand and without notice to anyone, setoff any liability owed to the Borrower by the Lender, whether or not due, against any Obligation, whether or not due. In addition, each other Person holding a participating interest in any Indebtedness shall have the right to appropriate or setoff any deposit or other liability then owed by such Person to the Borrower, whether or not due, and apply the same to the payment of said participating interest, as fully as if such Person had lent directly to the Borrower the amount of such participating interest.

Section 3.8 Collateral. This Agreement does not contemplate a sale of accounts, contract rights or chattel paper, and, as provided by law, the Borrower is entitled to any surplus and shall remain liable for any deficiency. The Lender's duty of care with respect to Collateral in its possession (as imposed by law) shall be deemed fulfilled if it exercises reasonable care in physically keeping such Collateral, or in the case of Collateral in the custody or possession of a bailee or other third Person, exercises reasonable care in the selection of the bailee or other third Person, and the Lender need not otherwise preserve, protect, insure or care for any Collateral. The Lender shall not be obligated to preserve any rights the Borrower may have against prior parties, to realize on the Collateral at all or in any particular manner or order or to apply any cash proceeds of the Collateral in any particular order of application. The Lender has no obligation to clean-up or otherwise prepare the Collateral for sale. The Borrower waives any right it may have to require the Lender to pursue any third Person for any of the Indebtedness.

Article 4

CONDITIONS OF LENDING

Section 4.1 Conditions Precedent to the Initial Advances. The Lender's obligation to make the initial Advances shall be subject to the condition precedent that the Lender shall have received all of the following, each properly executed by the appropriate party and in form and substance satisfactory to the Lender:

- (a) This Agreement.
- (b) The Revolving Note.
- (c) Copies of all documents relating to Ultimate Debtor Accounts that Lender may request.
- (d) A true and correct copy of any and all leases pursuant to which the Borrower is leasing the Premises, together with a landlord's disclaimer and consent with respect to each such lease.
- (e) A true and correct copy of any and all mortgages pursuant to which the Borrower has mortgaged the Premises, together with a mortgagee's disclaimer and consent with respect to each such mortgage.

(f) A true and correct copy of any and all agreements pursuant to which the Borrower's property is in the possession of any Person other than the Borrower, together with, in the case of any goods held by such Person for resale, (i) a consignee's acknowledgment and waiver of Liens, (ii) UCC financing statements sufficient to protect the Borrower's and the Lender's interests in such goods, and (iii) UCC searches showing that no other secured party has filed a financing statement against such Person (other than relating to Permitted Liens) and covering property similar to the Borrower's other than the Borrower, or if there exists any such secured party, evidence that each such secured party has received notice from the Borrower and the Lender sufficient to protect the Borrower's and the Lender's interests in the Borrower's goods from any claim by such secured party.

(g) **Reserved.**

(h) A true and correct copy of any and all agreements pursuant to which the Borrower's property is in the possession of any Person other than the Borrower, together with, (i) an acknowledgment and waiver of Liens from each subcontractor who has possession of the Borrower's goods from time to time, (ii) UCC financing statements sufficient to protect the Borrower's and the Lender's interests in such goods, and (iii) UCC searches showing that no other secured party has filed a financing statement covering such Person's property other than the Borrower, or if there exists any such secured party, evidence that each such secured party has received notice from the Borrower and the Lender sufficient to protect the Borrower's and the Lender's interests in the Borrower's goods from any claim by such secured party.

(i) **Reserved.**

(j) **Reserved.**

(k) The Wholesale Lockbox and Collection Account Agreement.

(l) Control agreements with each bank at which the Borrower maintains deposit accounts.

(m) **Reserved.**

(n) **Reserved.**

(o) **Reserved.**

(p) The Subordination Agreements.

(q) Current searches of appropriate filing offices showing that (i) no Liens have been filed and remain in effect against the Borrower except Permitted Liens or Liens held by Persons who have agreed in writing that upon receipt of proceeds of the initial Advances, they will satisfy, release or terminate such Liens in a manner satisfactory to the Lender, and (ii) the Lender has duly filed all financing statements necessary to perfect the Security Interest, to the extent the Security Interest is capable of being perfected by filing.

(r) A certificate of the Borrower's Secretary or Assistant Secretary certifying that attached to such certificate are (i) the resolutions of the Borrower's Directors and, if required, Owners, authorizing the execution, delivery and performance of the Loan Documents, (ii) true, correct and complete copies of the Borrower's Constituent Documents, and (iii) examples of the signatures of the Borrower's Officers or agents authorized to execute and deliver the Loan Documents and other instruments, agreements and certificates, including Advance requests, on the Borrower's behalf.

(s) A current certificate issued by the Secretary of State of Delaware, certifying that the Borrower is in compliance with all applicable organizational requirements of the State of Delaware.

(t) Evidence that the Borrower is duly licensed or qualified to transact business in all jurisdictions where the character of the property owned or leased or the nature of the business transacted by it makes such licensing or qualification necessary.

(u) A certificate of an Officer of the Borrower confirming, in his personal capacity, the representations and warranties set forth in Article V.

(v) **Reserved.**

(w) Certificates of the insurance required hereunder, with all hazard insurance containing a lender's loss payable endorsement in the Lender's favor and with all liability insurance naming the Lender as an additional insured.

(x) The separate Guaranty of each Guarantor, pursuant to which each Guarantor unconditionally guarantees the full and prompt payment of all Indebtedness.

(y) A waiver of interest issued by the spouse of each individual Guarantor, waiving any and all interest he or she may have in the assets disclosed to the Lender in the financial statements of that Guarantor and in any future earnings or assets acquired by that Guarantor.

(z) An opinion of counsel of Borrower, addressed to the Lender.

(aa) Payment of all fees due under the terms of this Agreement through the date of the initial Advance, and payment of all expenses incurred by the Lender through such date and that are required to be paid by the Borrower under this Agreement.

(bb) Evidence that after making the initial Revolving Advance, and satisfying all trade payables older than 90 days from invoice date, book overdrafts and closing costs, Availability shall be not less than \$1,000,000.

(cc) A Customer Identification Information form and such other forms and verification as the Lender may need to comply with the U.S.A. Patriot Act.

(dd) **Intentionally omitted.**

(ee) Such other documents as the Lender in its sole discretion may require.

Section 4.2 Conditions Precedent to All Advances. The Lender's obligation to make each Advance shall be subject to the further conditions precedent that:

(a) the representations and warranties contained in Article V are correct on and as of the date of such Advance as though made on and as of such date, except to the extent that such representations and warranties relate solely to an earlier date; and

(b) no event has occurred and is continuing beyond the expiration of all applicable grace and/or cure periods, or would result from such Advance which constitutes a Default or an Event of Default.

Article 5

REPRESENTATIONS AND WARRANTIES

The Borrower represents and warrants to the Lender as follows:

Section 5.1 Existence and Power; Name; Chief Executive Office; Inventory and Equipment Locations; Federal Employer Identification Number and Organizational Identification Number. The Borrower is a corporation, duly organized, validly existing and in good standing under the laws of the State of Delaware and is duly licensed or qualified to transact business in all jurisdictions where the character of the property owned or leased or the nature of the business transacted by it makes such licensing or qualification necessary. The Borrower has all requisite power and authority to conduct its business, to own its properties and to execute and deliver, and to perform all of its obligations under, the Loan Documents. During its existence, the Borrower has done business solely under the names set forth in Schedule 5.1. The Borrower's chief executive office and principal place of business is located at the address set forth in Schedule 5.1, and all of the Borrower's records relating to its business or the Collateral are kept at that location. All Inventory and Equipment is located at that location or at one of the other locations listed in Schedule 5.1. The Borrower's federal employer identification number and organization identification number are correctly set forth in Section 3.6.

Section 5.2 Capitalization. Schedule 5.2 constitutes a correct and complete list of all ownership interests of the Borrower and rights to acquire ownership interests including the record holder, number of interests and percentage interests on a fully diluted basis and an organizational chart showing the ownership structure of all Subsidiaries of the Borrower.

Section 5.3 Authorization of Borrowing; No Conflict as to Law or Agreements. The execution, delivery and performance by the Borrower of the Loan Documents and the borrowings from time to time hereunder have been duly authorized by all necessary corporate action and do not and will not (i) require any consent or approval of the Borrower's Owners; (ii) require any authorization, consent or approval by, or registration, declaration or filing with, or notice to, any governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, or any third party, except such authorization, consent, approval, registration, declaration, filing or notice as has been obtained, accomplished or given prior to the date hereof; (iii) violate any provision of any law, rule or regulation (including Regulation X of the Board of Governors of the Federal Reserve System) or of any order, writ,

injunction or decree presently in effect having applicability to the Borrower or of the Borrower's Constituent Documents; (iv) result in a breach of or constitute a default under any indenture or loan or credit agreement or any other material agreement, lease or instrument to which the Borrower is a party or by which it or its properties may be bound or affected; or (v) result in, or require, the creation or imposition of any Lien (other than the Security Interest) upon or with respect to any of the properties now owned or hereafter acquired by the Borrower.

Section 5.4 Legal Agreements. This Agreement constitutes and, upon due execution by the Borrower, the other Loan Documents will constitute the legal, valid and binding obligations of the Borrower, enforceable against the Borrower in accordance with their respective terms.

Section 5.5 Subsidiaries. Except as set forth in Schedule 5.5 hereto, the Borrower has no Subsidiaries.

Section 5.6 Financial Condition; No Adverse Change. The Borrower has furnished to the Lender its internally-prepared financial statements for its fiscal year ended December 31, 2006 and those statements fairly present the Borrower's financial condition on the dates thereof and the results of its operations and cash flows for the periods then ended and were prepared in accordance with GAAP. Since the date of the most recent financial statements, there has been no change in the Borrower's business, properties or condition (financial or otherwise) which has had a Material Adverse Effect.

Section 5.7 Litigation. There are no actions, suits or proceedings pending or, to the Borrower's knowledge, threatened against or affecting the Borrower or any of its Affiliates or the properties of the Borrower or any of its Affiliates before any court or governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, which, if determined adversely to the Borrower or any of its Affiliates, would have a Material Adverse Effect on the financial condition, properties or operations of the Borrower or any of its Affiliates.

Section 5.8 Regulation U. The Borrower is not engaged in the business of extending credit for the purpose of purchasing or carrying margin stock (within the meaning of Regulation U of the Board of Governors of the Federal Reserve System), and no part of the proceeds of any Advance will be used to purchase or carry any margin stock or to extend credit to others for the purpose of purchasing or carrying any margin stock.

Section 5.9 Taxes. The Borrower and its Affiliates have paid or caused to be paid to the proper authorities when due all federal, state and local taxes required to be withheld by each of them. The Borrower and its Affiliates have filed all federal, state and local tax returns which to the knowledge of the Officers of the Borrower or any Affiliate, as the case may be, are required to be filed, and the Borrower and its Affiliates have paid or caused to be paid to the respective taxing authorities all taxes as shown on said returns or on any assessment received by any of them to the extent such taxes have become due.

Section 5.10 Titles and Liens. The Borrower has good and absolute title to all Collateral free and clear of all Liens other than Permitted Liens. No financing statement naming the Borrower as debtor is on file in any office except to perfect only Permitted Liens.

Section 5.11 Intellectual Property Rights.

(a) **Owned Intellectual Property.** Schedule 5.11 is a complete list of all patents, applications for patents, trademarks, applications to register trademarks, service marks, applications to register service marks, mask works, trade dress and copyrights for which the Borrower is the owner of record (the “**Owned Intellectual Property**”). Except as disclosed on Schedule 5.11, (i) the Borrower owns the Owned Intellectual Property free and clear of all restrictions (including covenants not to sue a third party), court orders, injunctions, decrees, writs or Liens, whether by written agreement or otherwise, (ii) no Person other than the Borrower owns or has been granted any right in the Owned Intellectual Property, (iii) all Owned Intellectual Property is valid, subsisting and enforceable and (iv) the Borrower has taken all commercially reasonable action necessary to maintain and protect the Owned Intellectual Property.

(b) **Agreements with Employees and Contractors.** The Borrower has entered into a legally enforceable agreement with each of its employees and subcontractors obligating each such Person to assign to the Borrower, without any additional compensation, any Intellectual Property Rights created, discovered or invented by such Person in the course of such Person’s employment or engagement with the Borrower (except to the extent prohibited by law), and further requiring such Person to cooperate with the Borrower, without any additional compensation, in connection with securing and enforcing any Intellectual Property Rights therein; provided, however, that the foregoing shall not apply with respect to employees and subcontractors whose job descriptions are of the type such that no such assignments are reasonably foreseeable.

(c) **Intellectual Property Rights Licensed from Others.** Schedule 5.11 is a complete list of all agreements under which the Borrower has licensed Intellectual Property Rights from another Person (“**Licensed Intellectual Property**”) other than readily available, non-negotiated licenses of computer software and other intellectual property used solely for performing accounting, word processing and similar administrative tasks (“**Off-the-shelf Software**”) and a summary of any ongoing payments the Borrower is obligated to make with respect thereto. Except as disclosed on Schedule 5.11 and in written agreements, copies of which have been given to the Lender, the Borrower’s licenses to use the Licensed Intellectual Property are free and clear of all restrictions, Liens, court orders, injunctions, decrees, or writs, whether by written agreement or otherwise. Except as disclosed on Schedule 5.11, the Borrower is not obligated or under any liability whatsoever to make any payments of a material nature by way of royalties, fees or otherwise to any owner of, licensor of, or other claimant to, any Intellectual Property Rights.

(d) **Other Intellectual Property Needed for Business.** Except for Off-the-shelf Software and as disclosed on Schedule 5.11, the Owned Intellectual Property and the Licensed Intellectual Property constitute all Intellectual Property Rights used or necessary to conduct the Borrower’s business as it is presently conducted or as the Borrower reasonably foresees conducting it.

(e) **Infringement.** Except as disclosed on Schedule 5.11, the Borrower has no knowledge of, and has not received any written claim or notice alleging, any Infringement of

another Person's Intellectual Property Rights (including any written claim that the Borrower must license or refrain from using the Intellectual Property Rights of any third party) nor, to the Borrower's knowledge, is there any threatened claim or any reasonable basis for any such claim.

Section 5.12 Plans. Except as disclosed to the Lender in writing prior to the date hereof, neither the Borrower nor any ERISA Affiliate (a) maintains or has maintained any Pension Plan, (b) contributes or has contributed to any Multiemployer Plan or (c) provides or has provided post-retirement medical or insurance benefits with respect to employees or former employees (other than benefits required under Section 601 of ERISA, Section 4980B of the IRC or applicable state law). Neither the Borrower nor any ERISA Affiliate has received any notice or has any knowledge to the effect that it is not in full compliance with any of the requirements of ERISA, the IRC or applicable state law with respect to any Plan. No Reportable Event exists in connection with any Pension Plan. Each Plan which is intended to qualify under the IRC is so qualified, and no fact or circumstance exists which may have an adverse effect on the Plan's tax-qualified status. Neither the Borrower nor any ERISA Affiliate has (i) any accumulated funding deficiency (as defined in Section 302 of ERISA and Section 412 of the IRC) under any Plan, whether or not waived, (ii) any liability under Section 4201 or 4243 of ERISA for any withdrawal, partial withdrawal, reorganization or other event under any Multiemployer Plan or (iii) any liability or knowledge of any facts or circumstances which could result in any liability to the Pension Benefit Guaranty Corporation, the Internal Revenue Service, the Department of Labor or any participant in connection with any Plan (other than routine claims for benefits under the Plan).

Section 5.13 Default. The Borrower is in compliance with all provisions of all agreements, instruments, decrees and orders to which it is a party or by which it or its property is bound or affected, the breach or default of which could have a Material Adverse Effect.

Section 5.14 Environmental Matters.

(a) Except as disclosed on Schedule 5.14, to the best knowledge of Borrower, after due diligence, there are not present in, on or under the Premises any Hazardous Substances in such form or quantity as to create any material liability or obligation for either the Borrower or the Lender under the common law of any jurisdiction or under any Environmental Law, and no Hazardous Substances have ever been stored, buried, spilled, leaked, discharged, emitted or released in, on or under the Premises in such a way as to create any such material liability.

(b) Except as disclosed on Schedule 5.14, the Borrower has not disposed of Hazardous Substances in such a manner as to create any material liability under any Environmental Law.

(c) Except as disclosed on Schedule 5.14, there have not existed in the past, nor are there any threatened or impending requests, claims, notices, investigations, demands, administrative proceedings, hearings or litigation relating in any way to the Premises or the Borrower, alleging material liability under, violation of, or noncompliance with any Environmental Law or any license, permit or other authorization issued pursuant thereto.

(d) Except as disclosed on Schedule 5.14, the Borrower's businesses are and have in the past always been conducted in accordance with all Environmental Laws and all licenses, permits and other authorizations required pursuant to any Environmental Law and necessary for the lawful and efficient operation of such businesses are in the Borrower's possession and are in full force and effect, nor has the Borrower been denied insurance on grounds related to potential environmental liability. No permit required under any Environmental Law is scheduled to expire within 12 months and there is no threat that any such permit will be withdrawn, terminated, limited or materially changed.

(e) Except as disclosed on Schedule 5.14, the Premises are not and never have been listed on the National Priorities List, the Comprehensive Environmental Response, Compensation and Liability Information System or any similar federal, state or local list, schedule, log, inventory or database.

(f) Intentionally Omitted.

Section 5.15 Submissions to Lender. All financial and other information provided to the Lender by or on behalf of the Borrower in connection with the Borrower's request for the credit facilities contemplated hereby (i) is true and correct in all material respects, (ii) does not omit any material fact necessary to make such information not misleading and, (iii) as to projections, valuations or proforma financial statements, presents a good faith opinion as to such projections, valuations and proforma condition and results.

Section 5.16 Financing Statements. The Borrower has authorized the filing of financing statements sufficient when filed to perfect the Security Interest and the other security interests created by the Security Documents. When such financing statements are filed in the offices noted therein, the Lender will have a valid and perfected security interest in all Collateral which is capable of being perfected by filing financing statements. None of the Collateral is or will become a fixture on real estate, unless a sufficient fixture filing is in effect with respect thereto.

Section 5.17 Rights to Payment. Each right to payment and each instrument, document, chattel paper and other agreement constituting or evidencing Collateral is (or, in the case of all future Collateral, will be when arising or issued) the valid, genuine and legally enforceable obligation, subject to no defense, setoff or counterclaim, of the account debtor or other obligor named therein or in the Borrower's records pertaining thereto as being obligated to pay such obligation.

Section 5.18 Financial Solvency. Both before and after giving effect to the all of the transactions contemplated in the Loan Documents, none of the Borrower or its Affiliates:

(a) Was or will be "insolvent", as that term is used and defined in Section 101(32) of the United States Bankruptcy Code and Section 2 of the Uniform Fraudulent Transfer Act;

(b) Has unreasonably small capital or is engaged or about to engage in a business or a transaction for which any remaining assets of the Borrower or such Affiliate are unreasonably small;

(c) By executing, delivering or performing its obligations under the Loan Documents or other documents to which it is a party or by taking any action with respect thereto, intends to, nor believes that it will, incur debts beyond its ability to pay them as they mature;

(d) By executing, delivering or performing its obligations under the Loan Documents or other documents to which it is a party or by taking any action with respect thereto, intends to hinder, delay or defraud either its present or future creditors; and

(e) At this time contemplates filing a petition in bankruptcy or for an arrangement or reorganization or similar proceeding under any law of any jurisdiction, nor, to the best knowledge of the Borrower, is the subject of any actual, pending or threatened bankruptcy, insolvency or similar proceedings under any law of any jurisdiction.

Article 6

COVENANTS

So long as the Indebtedness shall remain unpaid, or the Credit Facility shall remain outstanding, the Borrower will comply with the following requirements, unless the Lender shall otherwise consent in writing:

Section 6.1 Reporting Requirements. The Borrower will deliver, or cause to be delivered, to the Lender each of the following, which shall be in form and detail acceptable to the Lender:

(a) **Annual Financial Statements.** As soon as available, and in any event within 90 days after the end of each fiscal year of the Borrower, commencing with the fiscal year ending December 31, 2007, the Borrower's audited financial statements with the unqualified opinion of independent certified public accountants selected by the Borrower and acceptable to the Lender, which annual financial statements shall include the Borrower's balance sheet as at the end of such fiscal year and the related statements of the Borrower's income, retained earnings and cash flows for the fiscal year then ended, prepared, if the Lender so requests, on a consolidating and consolidated basis to include any Affiliates, all in reasonable detail and prepared in accordance with GAAP, together with (i) copies of all management letters prepared by such accountants; (ii) a report signed by such accountants stating that in making the investigations necessary for said opinion they obtained no knowledge, except as specifically stated, of any Default or Event of Default and all relevant facts in reasonable detail to evidence, and the computations as to, whether or not the Borrower is in compliance with the Financial Covenants; and (iii) a certificate of the Borrower's chief financial officer stating that such financial statements have been prepared in accordance with GAAP, fairly represent the Borrower's financial position and the results of its operations, and whether or not such Officer has knowledge of the occurrence of any Default or Event of Default and, if so, stating in reasonable detail the facts with respect thereto.

(b) Period Financial Statements.

(1) **Quarterly Financial Statements** . As soon as available and in any event within 60 days after the end of each fiscal quarter of Borrower, commencing with the fiscal quarter ending March 31, 2007, reviewed balance sheet and statements of income and retained earnings of the Borrower as at the end of and for such month and for the year to date period then ended, reviewed by independent certified public accountants selected by the Borrower and acceptable to the Lender, prepared, if the Lender so requests, on a consolidating and consolidated basis to include any Affiliates, in reasonable detail and stating in comparative form the figures for the corresponding date and periods in the previous year, all prepared in accordance with GAAP, subject to year-end audit adjustments and which fairly represent the Borrower's financial position and the results of its operations; and accompanied by a certificate of the Borrower's chief financial officer, substantially in the form of **Exhibit B** hereto stating (i) that such financial statements have been prepared in accordance with GAAP, subject to year-end audit adjustments, and fairly represent the Borrower's financial position and the results of its operations, (ii) whether or not such Officer has knowledge of the occurrence of any Default or Event of Default not theretofore reported and remedied and, if so, stating in reasonable detail the facts with respect thereto, and (iii) all relevant facts in reasonable detail to evidence, and the computations as to, whether or not the Borrower is in compliance with the Financial Covenants.

(2) **Monthly Financial Statements** . As soon as available and in any event within 30 days after the end of each month, the unaudited/internal balance sheet and statements of income and retained earnings of the Borrower as at the end of and for such month and for the year to date period then ended, prepared, if the Lender so requests, on a consolidating and consolidated basis to include any Affiliates, in reasonable detail and stating in comparative form the figures for the corresponding date and periods in the previous year, all prepared in accordance with GAAP, subject to year-end audit adjustments and which fairly represent the Borrower's financial position and the results of its operations; and accompanied by a certificate of the Borrower's chief financial officer, substantially in the form of Exhibit B hereto stating (i) that such financial statements have been prepared in accordance with GAAP, subject to year-end audit adjustments, and fairly represent the Borrower's financial position and the results of its operations, (ii) whether or not such Officer has knowledge of the occurrence of any Default or Event of Default not theretofore reported and remedied and, if so, stating in reasonable detail the facts with respect thereto, and (iii) all relevant facts in reasonable detail to evidence, and the computations as to, whether or not the Borrower is in compliance with the Financial Covenants.

(c) **Collateral Reports** . Within 10 days after the end of each month or more frequently if the Lender so requires, the Borrower's accounts receivable and its accounts payable, and a calculation of the Borrower's Accounts, and Eligible Accounts as at the end of such month or shorter time period.

(d) **Projections** . No later than the 15 days after the beginning of each fiscal year, the Borrower's projected balance sheets, income statements, statements of cash flow and projected Availability for each month of the succeeding fiscal year, each in reasonable detail. Such items will be certified by the Officer who is the Borrower's chief financial officer as being the most accurate projections available and identical to the projections used by the Borrower for internal planning purposes and be delivered with a statement of underlying assumptions and such supporting schedules and information as the Lender may in its discretion require.

(e) Supplemental Reports .

(1) Weekly, or more frequently if the Lender so requires, the Borrower's "daily collateral reports", receivables schedules, collection reports, copies of invoices to account debtors (including Ultimate Debtors), sales, credit memos and cash receipts.

(2) Accounts receivable (including Ultimate Debtor Accounts) and accounts payable agings within 10 days of the end of each month. Accounts receivable aging shall be submitted by the Borrower electronically to Lender via its vendor, Collateral Services, Inc.

(f) **Litigation** . Immediately after the commencement thereof, notice in writing of all litigation and of all proceedings before any governmental or regulatory agency affecting the Borrower (i) of the type described in Section 5.14(c) or (ii) which seek a monetary recovery against the Borrower in excess of \$10,000.

(g) **Defaults** . When any Officer of the Borrower becomes aware of the probable occurrence of any Default or Event of Default, and no later than 3 days after such Officer becomes aware of such Default or Event of Default, notice of such occurrence, together with a detailed statement by a responsible Officer of the Borrower of the steps being taken by the Borrower to cure the effect thereof.

(h) **Plans** . As soon as possible, and in any event within 30 days after the Borrower knows or has reason to know that any Reportable Event with respect to any Pension Plan has occurred, a statement signed by the Officer who is the Borrower's chief financial officer setting forth details as to such Reportable Event and the action which the Borrower proposes to take with respect thereto, together with a copy of the notice of such Reportable Event to the Pension Benefit Guaranty Corporation. As soon as possible, and in any event within 10 days after the Borrower fails to make any quarterly contribution required with respect to any Pension Plan under Section 412 (m) of the IRC, the Borrower will deliver to the Lender a statement signed by the Officer who is the Borrower's chief financial officer setting forth details as to such failure and the action which the Borrower proposes to take with respect thereto, together with a copy of any notice of such failure required to be provided to the Pension Benefit Guaranty Corporation. As soon as possible, and in any event within ten days after the Borrower knows or has reason to know that it has or is reasonably expected to have any liability under Sections 4201 or 4243 of ERISA for any withdrawal, partial withdrawal, reorganization or other event under any Multiemployer Plan, the Borrower will deliver to the Lender a statement of the Borrower's chief financial officer setting forth details as to such liability and the action which the Borrower proposes to take with respect thereto.

(i) **Disputes** . Promptly upon knowledge thereof, notice of (i) any disputes or claims by the Borrower's Ultimate Debtors exceeding \$5,000 individually or \$25,000 in the aggregate during any fiscal year; (ii) credit memos; and (iii) any goods returned to or recovered by the Borrower.

(j) **Officers and Directors** . Promptly upon knowledge thereof, notice of any change in the persons constituting the Borrower's Officers and Directors.

(k) **Collateral** . Promptly upon knowledge thereof, notice of any loss of or material damage to any Collateral or of any substantial adverse change in any Collateral or the prospect of payment thereof.

(l) **Commercial Tort Claims** . Promptly upon knowledge thereof, notice of any commercial tort claims it may bring against any Person, including the name and address of each defendant, a summary of the facts, an estimate of the Borrower's damages, copies of any complaint or demand letter submitted by the Borrower, and such other information as the Lender may request.

(m) **Intellectual Property** .

(i) 30 days prior written notice of Borrower's intent to acquire material Intellectual Property Rights; except for transfers permitted under Section 6.18, the Borrower will give the Lender 30 days prior written notice of its intent to dispose of material Intellectual Property Rights and upon request shall provide the Lender with copies of all proposed documents and agreements concerning such rights.

(ii) Promptly upon knowledge thereof, notice of (A) any Infringement of its Intellectual Property Rights by others, (B) claims that the Borrower is Infringing another Person's Intellectual Property Rights and (C) any threatened cancellation, termination or material limitation of its Intellectual Property Rights.

(iii) Promptly upon receipt, copies of all registrations and filings with respect to its Intellectual Property Rights.

(n) **Reports to Owners** . Promptly upon their distribution, copies of all financial statements, reports and proxy statements which the Borrower shall have sent to its Owners.

(o) **SEC Filings** . Promptly after the sending or filing thereof, copies of all regular and periodic reports which the Borrower shall file with the Securities and Exchange Commission or any national securities exchange.

(p) **Tax Returns of Borrower** . As soon as possible, and in any event no later than five days after they are due to be filed, copies of the state and federal income tax returns and all schedules thereto of the Borrower.

(q) **Tax Returns and Personal Financial Statements of Guarantor** . As soon as possible and in any event no later than April 30th of each year, the current personal financial statement and state and federal income tax returns and all schedules thereto of each Guarantor.

(r) **Violations of Law** . Promptly upon knowledge thereof, notice of the Borrower's violation of any law, rule or regulation, the non-compliance with which could have a Material Adverse Effect on the Borrower.

(s) **Other Reports** . From time to time, with reasonable promptness, any and all receivables schedules, collection reports, deposit records, copies of invoices to account debtors, and such other material, reports, records or information as the Lender may request.

Section 6.2 Financial Covenants.

(a) **Minimum Tangible Net Worth.** The Borrower will maintain, during each period described below, its Tangible Net Worth in an amount not less than the amount set forth for each such fiscal quarter (numbers appearing between “< >” are negative):

Fiscal Quarter Ending	Minimum Tangible Net Worth
March 31, 2007	\$ 2,236,000
June 30, 2007	\$ 1,936,000
September 30, 2007	\$ 1,696,000
December 31, 2007	\$ 1,496,000
March 31, 2008	\$ 1,266,000
June 30, 2008	\$ 1,117,000
September 30, 2008	\$ 1,041,000
December 31, 2008	\$ 1,066,000

(b) **Minimum Net Income.** The Borrower will achieve, for each period described below, Net Income (on a non-cumulative basis) of not less than the amount set forth for each such fiscal quarter (numbers appearing between “< >” are negative):

Fiscal Quarter Ending	Minimum Net Income
March 31, 2007	<\$400,000>
June 30, 2007	<\$300,000>
September 30, 2007	<\$240,000>
December 31, 2007	<\$200,000>
March 31, 2008	<\$230,000>
June 30, 2008	<\$150,000>
September 30, 2008	<\$ 75,000>
December 31, 2008	\$ 25,000

(c) **Minimum Quarterly Net Cash Flow (non-cumulative).** The Borrower will achieve Net Cash Flow on a non-cumulative basis of not less than the amount set forth for each such fiscal quarter (numbers appearing between “< >” are negative):

<u>Quarter Ending</u>	<u>Minimum Net Cash Flow</u>
March 31, 2007	<\$268,000>
June 30, 2007	<\$173,000>
September 30, 2007	<\$113,000>
December 31, 2007	<\$73,000>
March 31, 2008	<\$103,000>
June 30, 2008	<\$22,000>
September 30, 2008	\$ 55,000
December 31, 2008	\$ 101,000

(d) **Capital Expenditures.** The Borrower will not incur or contract to incur Capital Expenditures of more than \$300,000 in the aggregate during any fiscal year, of which the unfinanced portion cannot exceed \$200,000.

(e) **Minimum Availability.** Borrower shall at all times maintain a minimum Availability of not less than \$25,000.

Section 6.3 Permitted Liens; Financing Statements.

(a) The Borrower will not create, incur or suffer to exist any Lien upon or of any of its assets, now owned or hereafter acquired, to secure any indebtedness; excluding, however, from the operation of the foregoing, the following (each a “**Permitted Lien**” ; collectively, “**Permitted Liens**”) :

(i) In the case of any of the Borrower’s property which is not Collateral, covenants, restrictions, rights, easements and minor irregularities in title which do not materially interfere with the Borrower’s business or operations as presently conducted;

(ii) Liens in existence on the date hereof and listed in Schedule 6.3 hereto, securing indebtedness for borrowed money permitted under this Agreement;

(iii) The Security Interest and Liens created by the Security Documents;

(iv) Purchase money Liens relating to the acquisition of machinery and equipment of the Borrower not exceeding the lesser of cost or fair market value thereof, not

exceeding \$25,000 for any one purchase or \$200,000 in the aggregate during any fiscal year, and so long as no Default Period is then in existence and none would exist immediately after such acquisition; and

(v) Liens in favor of the Subordinated Creditors so long as such Liens are subordinated to the Liens in favor of the Lender on terms satisfactory to Lender.

(b) The Borrower will not amend any financing statements in favor of the Lender except as permitted by law. Any authorization by the Lender to any Person to amend financing statements in favor of the Lender shall be in writing.

Section 6.4 Indebtedness. The Borrower will not incur, create, assume or permit to exist any indebtedness or liability on account of deposits or advances or any indebtedness for borrowed money or letters of credit issued on the Borrower's behalf, or any other indebtedness or liability evidenced by notes, bonds, debentures or similar obligations, except:

- (a) Any existing or future Indebtedness or any other obligations of the Borrower to the Lender;
- (b) Any indebtedness of the Borrower in existence on the date hereof and listed in Schedule 6.4 hereto; and
- (c) Any indebtedness relating to Permitted Liens.

Section 6.5 Guaranties. The Borrower will not assume, guarantee, endorse or otherwise become directly or contingently liable in connection with any obligations of any other Person, except:

- (a) The endorsement of negotiable instruments by the Borrower for deposit or collection or similar transactions in the ordinary course of business; and
- (b) Guaranties, endorsements and other direct or contingent liabilities in connection with the obligations of other Persons, in existence on the date hereof and listed in Schedule 6.4 hereto.

Section 6.6 Investments and Subsidiaries. The Borrower will not make or permit to exist any loans or advances to, or make any investment or acquire any interest whatsoever in, any other Person or Affiliate, including any partnership or joint venture, nor purchase or hold beneficially any stock or other securities or evidence of indebtedness of any other Person or Affiliate, except:

- (a) Investments in direct obligations of the United States of America or any agency or instrumentality thereof whose obligations constitute full faith and credit obligations of the United States of America having a maturity of one year or less, commercial paper issued by U.S. corporations rated "A-1" or "A-2" by Standard & Poor's Ratings Services or "P-1" or "P-2" by Moody's Investors Service or certificates of deposit or bankers' acceptances having a maturity of one year or less issued by members of the Federal Reserve System having deposits

in excess of \$100,000,000 (which certificates of deposit or bankers' acceptances are fully insured by the Federal Deposit Insurance Corporation);

- (b) Travel advances or loans to the Borrower's Officers and employees not exceeding at any one time an aggregate of \$5,000;
- (c) Prepaid rent not exceeding one month or security deposits; and
- (d) Current investments in the Subsidiaries in existence on the date hereof and listed in Schedule 5.5 hereto.

Section 6.7 Dividends and Distributions. Except as set forth in this Section 6.7, the Borrower will not declare or pay any dividends (other than dividends payable solely in stock of the Borrower) on any class of its stock, or make any payment on account of the purchase, redemption or other retirement of any shares of such stock, or other securities or evidence of its indebtedness or make any distribution in respect thereof, either directly or indirectly.

Section 6.8 Salaries. The Borrower will not pay excessive or unreasonable salaries, bonuses, commissions, consultant fees or other compensation; or increase the salary, bonus, commissions, consultant fees or other compensation of any Director, Officer or consultant, or any member of their families, by more than ten percent (10%) in any one year, either individually or for all such persons in the aggregate, or pay any such increase from any source other than profits earned in the year of payment.

Section 6.9 Intentionally Omitted.

Section 6.10 Books and Records; Collateral Examination, Inspection and Appraisals.

(a) The Borrower will keep accurate books of record and account for itself pertaining to the Collateral and pertaining to the Borrower's business and financial condition and such other matters as the Lender may from time to time request in which true and complete entries will be made in accordance with GAAP and, upon the Lender's request, will permit any officer, employee, attorney, accountant or other agent of the Lender to audit, review, make extracts from or copy any and all company and financial books and records of the Borrower at all times during ordinary business hours, to send and discuss with account debtors and other obligors requests for verification of amounts owed to the Borrower, and to discuss the Borrower's affairs with any of its Directors, Officers, employees or agents.

(b) The Borrower hereby irrevocably authorizes all accountants and third parties to disclose and deliver to the Lender or its designated agent, at the Borrower's expense, all financial information, books and records, work papers, management reports and other information in their possession regarding the Borrower.

(c) The Borrower will permit the Lender or its employees, accountants, attorneys or agents, to examine and inspect any Collateral or any other property of the Borrower at any time during ordinary business hours.

Section 6.11 Account Verification.

(a) The Lender or its agent may at any time and from time to time send or require the Borrower to send requests for verification of accounts or notices of assignment to account debtors (including, without limitation, Ultimate Debtor Customers) and other obligors. The Lender or its agent may also at any time and from time to time telephone account debtors and other obligors to verify accounts.

(b) The Borrower shall pay when due each account payable due to a Person holding a Permitted Lien (as a result of such payable) on any Collateral.

Section 6.12 Compliance with Laws.

(a) The Borrower shall (i) comply, and cause each Subsidiary to comply, with the requirements of applicable laws and regulations, the non-compliance with which would materially and adversely affect its business or its financial condition and (ii) use and keep the Collateral, and require that others use and keep the Collateral, only for lawful purposes, without violation of any federal, state or local law, statute or ordinance.

(b) Without limiting the foregoing undertakings, the Borrower specifically agrees that it will comply, and cause each Subsidiary to comply, with all applicable Environmental Laws and obtain and comply with all permits, licenses and similar approvals required by any Environmental Laws, and will not generate, use, transport, treat, store or dispose of any Hazardous Substances in such a manner as to create any material liability or obligation under the common law of any jurisdiction or any Environmental Law.

(c) The Borrower shall (i) ensure, and cause each Subsidiary to ensure, that no Owner shall be listed on the Specially Designated Nationals and Blocked Person List or other similar lists maintained by the Office of Foreign Assets Control ("**OFAC**"), the Department of the Treasury or included in any Executive Orders, (ii) not use or permit the use of the proceeds of the Credit Facility or any other financial accommodation from the Lender to violate any of the foreign asset control regulations of OFAC or other applicable law, (iii) comply, and cause each Subsidiary to comply, with all applicable Bank Secrecy Act laws and regulations, as amended from time to time, and (iv) otherwise comply with the USA Patriot Act as required by federal law and the Lender's policies and practices.

Section 6.13 Payment of Taxes and Other Claims . The Borrower will pay or discharge, when due, (a) all taxes, assessments and governmental charges levied or imposed upon it or upon its income or profits, upon any properties belonging to it (including the Collateral) or upon or against the creation, perfection or continuance of the Security Interest, prior to the date on which penalties attach thereto, (b) all federal, state and local taxes required to be withheld by it, and (c) all lawful claims for labor, materials and supplies which, if unpaid, might by law become a Lien upon any properties of the Borrower; provided, that the Borrower shall not be required to pay any such tax, assessment, charge or claim whose amount, applicability or validity is being contested in good faith by appropriate proceedings and for which proper reserves have been made.

Section 6.14 Maintenance of Properties.

(a) The Borrower will keep and maintain the Collateral and all of its other properties necessary or useful in its business in good condition, repair and working order (normal wear and tear excepted) and will from time to time replace or repair any worn, defective or broken parts; provided, however, that nothing in this covenant shall prevent the Borrower from discontinuing the operation and maintenance of any of its properties if such discontinuance is, in the Borrower's judgment, desirable in the conduct of the Borrower's business and not disadvantageous in any material respect to the Lender. The Borrower will take all commercially reasonable steps necessary to protect and maintain its Intellectual Property Rights.

(b) The Borrower will defend the Collateral against all Liens, claims or demands of all Persons (other than the Lender) claiming the Collateral or any interest therein. The Borrower will keep all Collateral free and clear of all Liens except Permitted Liens. The Borrower will take all commercially reasonable steps necessary to prosecute any Person Infringing its Intellectual Property Rights and to defend itself against any Person accusing it of Infringing any Person's Intellectual Property Rights.

Section 6.15 Insurance. The Borrower will obtain and at all times maintain insurance with insurers acceptable to the Lender, in such amounts, on such terms (including any deductibles) and against such risks as may from time to time be required by the Lender, but in all events in such amounts and against such risks as is usually carried by companies engaged in similar business and owning similar properties in the same general areas in which the Borrower operates. Without limiting the generality of the foregoing, the Borrower will at all times maintain business interruption insurance including coverage for force majeure and keep all tangible Collateral insured against risks of fire (including so-called extended coverage), theft, collision (for Collateral consisting of motor vehicles) and such other risks and in such amounts as the Lender may reasonably request, with any loss payable to the Lender to the extent of its interest, and all policies of such insurance shall contain a lender's loss payable endorsement for the Lender's benefit. All policies of liability insurance required hereunder shall name the Lender as an additional insured.

Section 6.16 Preservation of Existence. The Borrower will preserve and maintain its existence and all of its rights, privileges and franchises necessary or desirable in the normal conduct of its business and shall conduct its business in an orderly, efficient and regular manner.

Section 6.17 Delivery of Instruments, etc. Upon request by the Lender, the Borrower will promptly deliver to the Lender in pledge all instruments, documents and chattel paper constituting Collateral, duly endorsed or assigned by the Borrower.

Section 6.18 Sale or Transfer of Assets; Suspension of Business Operations. The Borrower will not sell, lease, assign, transfer or otherwise dispose of (i) the stock of any Subsidiary, (ii) all or a substantial part of its assets, or (iii) any Collateral or any interest therein (whether in one transaction or in a series of transactions) to any other Person other than the sale of Inventory in the ordinary course of business and will not liquidate, dissolve or suspend business operations. The Borrower will not transfer any part of its ownership interest in any Intellectual Property Rights and will not permit any agreement under which it has licensed Licensed Intellectual Property to lapse, except that the Borrower may transfer such rights or

permit such agreements to lapse if it shall have reasonably determined that the applicable Intellectual Property Rights are no longer useful in its business. If the Borrower transfers any Intellectual Property Rights for value, the Borrower will pay over the proceeds to the Lender for application to the Indebtedness. The Borrower will not license any other Person to use any of the Borrower's Intellectual Property Rights, except that the Borrower may grant licenses in the ordinary course of its business in connection with sales of Inventory or provision of services to its customers.

Section 6.19 Consolidation and Merger; Asset Acquisitions. The Borrower will not consolidate with or merge into any Person, or permit any other Person to merge into it, or acquire (in a transaction analogous in purpose or effect to a consolidation or merger) all or substantially all the assets of any other Person.

Section 6.20 Sale and Leaseback. The Borrower will not enter into any arrangement, directly or indirectly, with any other Person whereby the Borrower shall sell or transfer any real or personal property, whether now owned or hereafter acquired, and then or thereafter rent or lease as lessee such property or any part thereof or any other property which the Borrower intends to use for substantially the same purpose or purposes as the property being sold or transferred.

Section 6.21 Restrictions on Nature of Business. The Borrower will not engage in any line of business materially different from that presently engaged in by the Borrower and will not purchase, lease or otherwise acquire assets not related to its business.

Section 6.22 Accounting. The Borrower will not adopt any material change in accounting principles other than as required by GAAP. The Borrower will not adopt, permit or consent to any change in its fiscal year.

Section 6.23 Discounts, etc.. After notice from the Lender, the Borrower will not grant any discount, credit or allowance to any Ultimate Debtor or to any Ultimate Debtor Customer or accept any return of goods sold. The Borrower will not at any time modify, amend, subordinate, cancel or terminate the obligation of any Ultimate Debtor or other obligor of the Borrower.

Section 6.24 Plans. Except as disclosed to the Lender in writing prior to the date hereof, neither the Borrower nor any ERISA Affiliate will (i) adopt, create, assume or become a party to any Pension Plan, (ii) incur any obligation to contribute to any Multiemployer Plan, (iii) incur any obligation to provide post-retirement medical or insurance benefits with respect to employees or former employees (other than benefits required by law) or (iv) amend any Plan in a manner that would materially increase its funding obligations.

Section 6.25 Place of Business; Name. The Borrower will not transfer its chief executive office or principal place of business, or move, relocate, close or sell any business location. The Borrower will not permit any tangible Collateral or any records pertaining to the Collateral to be located in any state or area in which, in the event of such location, a financing statement covering such Collateral would be required to be, but has not in fact been, filed in order to perfect the Security Interest. The Borrower will not change its name or jurisdiction of organization.

Section 6.26 Constituent Documents; S Corporation Status. The Borrower will not amend its Constituent Documents. The Borrower will not become an S Corporation.

Section 6.27 Performance by the Lender. If the Borrower at any time fails to perform or observe any of the foregoing covenants contained in this Article VI or elsewhere herein, and if such failure shall continue for a period of ten calendar days after the Lender gives the Borrower written notice thereof (or in the case of the agreements contained in Section 6.13 and Section 6.15, immediately upon the occurrence of such failure, without notice or lapse of time), the Lender may, but need not, perform or observe such covenant on behalf and in the name, place and stead of the Borrower (or, at the Lender's option, in the Lender's name) and may, but need not, take any and all other actions which the Lender may reasonably deem necessary to cure or correct such failure (including the payment of taxes, the satisfaction of Liens, the performance of obligations owed to account debtors or other obligors, the procurement and maintenance of insurance, the execution of assignments, security agreements and financing statements, and the endorsement of instruments); and the Borrower shall thereupon pay to the Lender on demand the amount of all monies expended and all costs and expenses (including reasonable attorneys' fees and legal expenses) incurred by the Lender in connection with or as a result of the performance or observance of such agreements or the taking of such action by the Lender, together with interest thereon from the date expended or incurred at the Default Rate. To facilitate the Lender's performance or observance of such covenants of the Borrower, the Borrower hereby irrevocably appoints the Lender, or the Lender's delegate, acting alone, as the Borrower's attorney in fact (which appointment is coupled with an interest) with the right (but not the duty) from time to time to create, prepare, complete, execute, deliver, endorse or file in the name and on behalf of the Borrower any and all instruments, documents, assignments, security agreements, financing statements, applications for insurance and other agreements and writings required to be obtained, executed, delivered or endorsed by the Borrower hereunder.

Section 6.28 Dissolution of Funding Services I, LLC and Store Charge, Inc. Borrower shall provide Lender with evidence satisfactory to Lender of the dissolution of Funding Services I, LLC, including, without limitation, a filed certificate of dissolution from the Secretary of State of the State of Delaware, within 90 days of the Funding Date. Borrower shall provide Lender with evidence satisfactory to Lender of the dissolution of Store Charge, Inc., including, without limitation, a filed certificate of dissolution from the Secretary of State of the State of New York, within 90 days of the Funding Date.

Article 7

EVENTS OF DEFAULT, RIGHTS AND REMEDIES

Section 7.1 Events of Default. "Event of Default", wherever used herein, means any one of the following events:

(a) Default in the payment of the Revolving Note, any Obligation of Reimbursement, or any default with respect to any other Indebtedness due from Borrower to Lender as such Indebtedness becomes due and payable;

(b) Default in the performance, or breach, of any covenant or agreement of the Borrower contained in this Agreement, provided, however, that failure to comply with the covenants outlined in Sections 6.1(a), (b), (c) and (d) hereof shall not constitute an Event of Default until five (5) days have lapsed from the date of required performance;

(c) An Overadvance arises as the result of any reduction in the Borrowing Base, or arises in any manner on terms not otherwise approved of in advance by the Lender in writing;

(d) A Change of Control shall occur;

(e) Any Financial Covenant shall become inapplicable due to the lapse of time and the failure of the Lender and the Borrower to come to any agreement to amend any such covenant to cover future periods that is acceptable to the Lender in the Lender's sole discretion;

(f) The Borrower or any Guarantor shall be or become insolvent, or admit in writing its or his inability to pay its or his debts as they mature, or make an assignment for the benefit of creditors; or the Borrower or any Guarantor shall apply for or consent to the appointment of any receiver, trustee, or similar officer for it or him or for all or any substantial part of its or his property; or such receiver, trustee or similar officer shall be appointed without the application or consent of the Borrower or such Guarantor, as the case may be; or the Borrower or any Guarantor shall institute (by petition, application, answer, consent or otherwise) any bankruptcy, insolvency, reorganization, arrangement, readjustment of debt, dissolution, liquidation or similar proceeding relating to it or him under the laws of any jurisdiction; or any such proceeding shall be instituted (by petition, application or otherwise) against the Borrower or any such Guarantor and shall not be dismissed within 30 days of the filing thereof; or any judgment, writ, warrant of attachment or execution or similar process shall be issued or levied against a substantial part of the property of the Borrower or any Guarantor and not discharged within 30 days of the entry thereof;

(g) A petition shall be filed by or against the Borrower or any Guarantor under the United States Bankruptcy Code or the laws of any other jurisdiction naming the Borrower or such Guarantor as debtor, provided that, in the case of a filing against the Borrower or any Guarantor, Borrower or Guarantor, as applicable, shall have 30 days from the filing thereof to obtain a discharge or dismissal of such petition;

(h) **Reserved;**

(i) Any representation or warranty made by the Borrower in this Agreement, by any Guarantor in any Guaranty delivered to the Lender, or by the Borrower (or any of its Officers) or any Guarantor in any agreement, certificate, instrument or financial statement or other statement contemplated by or made or delivered pursuant to or in connection with this Agreement or any such Guaranty shall be incorrect in any material respect;

(j) The rendering against the Borrower of an arbitration award, a final judgment, decree or order for the payment of money in excess of \$10,000 and the continuance of such arbitration award, judgment, decree or order unsatisfied and in effect for any period of 30 consecutive days without a stay of execution;

(k) A default under any bond, debenture, note or other evidence of material indebtedness of the Borrower owed to any Person other than the Lender, or under any indenture or other instrument under which any such evidence of indebtedness has been issued or by which it is governed, or under any material lease or other contract, and the expiration of the applicable period of grace, if any, specified in such evidence of indebtedness, indenture, other instrument, lease or contract;

(l) Any Reportable Event, which the Lender determines in good faith might constitute grounds for the termination of any Pension Plan or for the appointment by the appropriate United States District Court of a trustee to administer any Pension Plan, shall have occurred and be continuing 30 days after written notice to such effect shall have been given to the Borrower by the Lender; or a trustee shall have been appointed by an appropriate United States District Court to administer any Pension Plan; or the Pension Benefit Guaranty Corporation shall have instituted proceedings to terminate any Pension Plan or to appoint a trustee to administer any Pension Plan; or the Borrower or any ERISA Affiliate shall have filed for a distress termination of any Pension Plan under Title IV of ERISA; or the Borrower or any ERISA Affiliate shall have failed to make any quarterly contribution required with respect to any Pension Plan under Section 412(m) of the IRC, which the Lender determines in good faith may by itself, or in combination with any such failures that the Lender may determine are likely to occur in the future, result in the imposition of a Lien on the Borrower's assets in favor of the Pension Plan; or any withdrawal, partial withdrawal, reorganization or other event occurs with respect to a Multiemployer Plan which results or could reasonably be expected to result in a material liability of the Borrower to the Multiemployer Plan under Title IV of ERISA;

(m) An event of default shall occur under any Security Document;

(n) Default in the payment of any amount owed by the Borrower to the Lender other than any Indebtedness arising hereunder;

(o) Any Guarantor in favor of the Lender shall repudiate, purport to revoke or fail to perform any obligation under such Guaranty in favor of the Lender, any individual Guarantor shall die or any other Guarantor shall cease to exist;

(p) The Borrower shall take or participate in any action which would be prohibited under the provisions of any Subordination Agreement or make any payment with respect to indebtedness that has been subordinated pursuant to any Subordination Agreement;

(q) The Lender believes in good faith that the prospect of payment in full of any part of the Indebtedness, or that full performance by the Borrower under the Loan Documents, is impaired, or that there has occurred any material adverse change in the business or financial condition of the Borrower;

(r) There has occurred any breach, default or event of default by or attributable to, any Affiliate under any agreement between the Affiliate and the Lender; or

(s) The indictment of any Director, Officer, Guarantor, or any Owner of at least twenty (20%) of the issued and outstanding common stock of the Borrower for a felony offence under state or federal law.

Section 7.2 Rights and Remedies. During any Default Period, the Lender may exercise any or all of the following rights and remedies:

(a) The Lender may, by notice to the Borrower, declare the Commitment to be terminated, whereupon the same shall forthwith terminate;

(b) The Lender may, by notice to the Borrower, declare the Indebtedness to be forthwith due and payable, whereupon all Indebtedness shall become and be forthwith due and payable, without presentment, notice of dishonor, protest or further notice of any kind, all of which the Borrower hereby expressly waives;

(c) The Lender may, without notice to the Borrower and without further action, apply any and all money owing by the Lender to the Borrower to the payment of the Indebtedness;

(d) The Lender may exercise and enforce any and all rights and remedies available upon default to a secured party under the UCC, including the right to take possession of Collateral, or any evidence thereof, proceeding without judicial process or by judicial process (without a prior hearing or notice thereof, which the Borrower hereby expressly waives) and the right to sell, lease or otherwise dispose of any or all of the Collateral (with or without giving any warranties as to the Collateral, title to the Collateral or similar warranties), and, in connection therewith, the Borrower will on demand assemble the Collateral and make it available to the Lender at a place to be designated by the Lender which is reasonably convenient to both parties;

(e) **Intentionally omitted**

(f) The Lender may exercise and enforce its rights and remedies under the Loan Documents;

(g) The Lender may without regard to any waste, adequacy of the security or solvency of the Borrower, apply for the appointment of a receiver of the Collateral, to which appointment the Borrower hereby consents, whether or not foreclosure proceedings have been commenced under the Security Documents and whether or not a foreclosure sale has occurred; and

(h) The Lender may exercise any other rights and remedies available to it by law or agreement.

Notwithstanding the foregoing, upon the occurrence of an Event of Default described in Section 7.1(f) or (g), the Indebtedness shall be immediately due and payable automatically without presentment, demand, protest or notice of any kind. If the Lender sells any of the Collateral on credit, the Indebtedness will be reduced only to the extent of payments actually received. If the purchaser fails to pay for the Collateral, the Lender may resell the Collateral and shall apply any proceeds actually received to the Indebtedness.

Section 7.3 Certain Notices. If notice to the Borrower of any intended disposition of Collateral or any other intended action is required by law in a particular instance, such notice shall be deemed commercially reasonable if given (in the manner specified in Section 8.3) at least ten calendar days before the date of intended disposition or other action.

Article 8

MISCELLANEOUS

Section 8.1 No Waiver; Cumulative Remedies; Compliance with Laws. No failure or delay by the Lender in exercising any right, power or remedy under the Loan Documents shall operate as a waiver thereof; nor shall any single or partial exercise of any such right, power or remedy preclude any other or further exercise thereof or the exercise of any other right, power or remedy under the Loan Documents. The remedies provided in the Loan Documents are cumulative and not exclusive of any remedies provided by law. The Lender may comply with any applicable state or federal law requirements in connection with a disposition of the Collateral and such compliance will not be considered adversely to affect the commercial reasonableness of any sale of the Collateral.

Section 8.2 Amendments, Etc.. No amendment, modification, termination or waiver of any provision of any Loan Document or consent to any departure by the Borrower therefrom or any release of a Security Interest shall be effective unless the same shall be in writing and signed by the Lender, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given. No notice to or demand on the Borrower in any case shall entitle the Borrower to any other or further notice or demand in similar or other circumstances.

Section 8.3 Notices; Communication of Confidential Information; Requests for Accounting. Except as otherwise expressly provided herein, all notices, requests, demands and other communications provided for under the Loan Documents shall be in writing and shall be (a) personally delivered, (b) sent by first class United States mail, (c) sent by overnight courier of national reputation, (d) transmitted by telecopy, or (e) sent as electronic mail, in each case delivered or sent to the party to whom notice is being given to the business address, telecopier number, or e mail address set forth below next to its signature or, as to each party, at such other business address, telecopier number, or e mail address as it may hereafter designate in writing to the other party pursuant to the terms of this Section. All such notices, requests, demands and other communications shall be deemed to be an authenticated record communicated or given on (a) the date received if personally delivered, (b) when deposited in the mail if delivered by mail, (c) the date delivered to the courier if delivered by overnight courier, or (d) the date of transmission if sent by telecopy or by e mail, except that notices or requests delivered to the Lender pursuant to any of the provisions of Article II shall not be effective until received by the Lender. All notices, financial information, or other business records sent by either party to this Agreement may be transmitted, sent, or otherwise communicated via such medium as the sending party may deem appropriate and commercially reasonable; provided, however, that the

risk that the confidentiality or privacy of such notices, financial information, or other business records sent by the Borrower may be compromised shall be borne exclusively by the Borrower. All requests for an accounting under Section 9-210 of the UCC (i) shall be made in a writing signed by a Person authorized under Section 2.2(b), (ii) shall be personally delivered, sent by registered or certified mail, return receipt requested, or by overnight courier of national reputation, (iii) shall be deemed to be sent when received by the Lender and (iv) shall otherwise comply with the requirements of Section 9-210. The Borrower requests that the Lender respond to all such requests which on their face appear to come from an authorized individual and releases the Lender from any liability for so responding. The Borrower shall pay the Lender the maximum amount allowed by law for responding to such requests.

Section 8.4 Further Documents. The Borrower will from time to time execute, deliver, endorse and authorize the filing of any and all instruments, documents, conveyances, assignments, security agreements, financing statements, control agreements and other agreements and writings that the Lender may reasonably request in order to secure, protect, perfect or enforce the Security Interest or the Lender's rights under the Loan Documents (but any failure to request or assure that the Borrower executes, delivers, endorses or authorizes the filing of any such item shall not affect or impair the validity, sufficiency or enforceability of the Loan Documents and the Security Interest, regardless of whether any such item was or was not executed, delivered or endorsed in a similar context or on a prior occasion).

Section 8.5 Costs and Expenses. The Borrower shall pay on demand all costs and expenses, including reasonable attorneys' fees, incurred by the Lender in connection with the Indebtedness, this Agreement, the Loan Documents, any Letter of Credit and any other document or agreement related hereto or thereto, and the transactions contemplated hereby, including all such costs, expenses and fees incurred in connection with the negotiation, preparation, execution, amendment, administration, performance, collection and enforcement of the Indebtedness and all such documents and agreements and the creation, perfection, protection, satisfaction, foreclosure or enforcement of the Security Interest.

Section 8.6 Indemnity. In addition to the payment of expenses pursuant to Section 8.5, the Borrower shall indemnify, defend and hold harmless the Lender, and any of its participants, parent corporations, subsidiary corporations, affiliated corporations, successor corporations, and all present and future officers, directors, employees, attorneys and agents of the foregoing (the "**Indemnitees**") from and against any of the following (collectively, "**Indemnified Liabilities**") :

(a) Any and all transfer taxes, documentary taxes, assessments or charges made by any governmental authority by reason of the execution and delivery of the Loan Documents or the making of the Advances;

(i) Any claims, loss or damage to which any Indemnitee may be subjected if any representation or warranty contained in Section 5.14 proves to be incorrect in any respect or as a result of any violation of the covenant contained in Section 6.12(b); and

(ii) Any and all other liabilities, losses, damages, penalties, judgments, suits, claims, costs and expenses of any kind or nature whatsoever (including the reasonable fees and

disbursements of counsel) in connection with the foregoing and any other investigative, administrative or judicial proceedings, whether or not such Indemnatee shall be designated a party thereto, which may be imposed on, incurred by or asserted against any such Indemnatee, in any manner related to or arising out of or in connection with the making of the Advances and the Loan Documents or the use or intended use of the proceeds of the Advances.

If any investigative, judicial or administrative proceeding arising from any of the foregoing is brought against any Indemnatee, upon such Indemnatee's request, the Borrower, or counsel designated by the Borrower and satisfactory to the Indemnatee, will resist and defend such action, suit or proceeding to the extent and in the manner directed by the Indemnatee, at the Borrower's sole costs and expense. Each Indemnatee will use its best efforts to cooperate in the defense of any such action, suit or proceeding. If the foregoing undertaking to indemnify, defend and hold harmless may be held to be unenforceable because it violates any law or public policy, the Borrower shall nevertheless make the maximum contribution to the payment and satisfaction of each of the Indemnified Liabilities which is permissible under applicable law. The Borrower's obligations under this Section 8.6 shall survive the termination of this Agreement and the discharge of the Borrower's other obligations hereunder.

Section 8.7 Participants. The Lender and its participants, if any, are not partners or joint venturers, and the Lender shall not have any liability or responsibility for any obligation, act or omission of any of its participants. All rights and powers specifically conferred upon the Lender may be transferred or delegated to any of the Lender's participants, successors or assigns.

Section 8.8 Execution in Counterparts; Telefacsimile Execution. This Agreement and other Loan Documents may be executed in any number of counterparts, each of which when so executed and delivered shall be deemed to be an original and all of which counterparts, taken together, shall constitute but one and the same instrument. Delivery of an executed counterpart of this Agreement by telefacsimile shall be equally as effective as delivery of an original executed counterpart of this Agreement. Any party delivering an executed counterpart of this Agreement by telefacsimile also shall deliver an original executed counterpart of this Agreement but the failure to deliver an original executed counterpart shall not affect the validity, enforceability, and binding effect of this Agreement.

Section 8.9 Retention of Borrower's Records. The Lender shall have no obligation to maintain any electronic records or any documents, schedules, invoices, agings, or other papers delivered to the Lender by the Borrower or in connection with the Loan Documents for more than 30 days after receipt by the Lender. If there is a special need to retain specific records, the Borrower must inform the Lender of its need to retain those records with particularity, which must be delivered in accordance with the notice provisions of Section 8.3 within 30 days of the Lender taking control of same.

Section 8.10 Binding Effect; Assignment; Complete Agreement; Sharing Information. The Loan Documents shall be binding upon and inure to the benefit of the Borrower and the Lender and their respective successors and assigns, except that the Borrower shall not have the right to assign its rights thereunder or any interest therein without the Lender's prior written consent. To the extent permitted by law, the Borrower waives and will not assert against any assignee any claims, defenses or set-offs which the Borrower could assert against the Lender.

This Agreement shall also bind all Persons who become a party to this Agreement as a borrower. This Agreement, together with the Loan Documents, comprises the complete and integrated agreement of the parties on the subject matter hereof and supersedes all prior agreements, written or oral, on the subject matter hereof. To the extent that any provision of this Agreement contradicts other provisions of the Loan Documents, this Agreement shall control. Without limiting the Lender's right to share information regarding the Borrower and its Affiliates with the Lender's participants, accountants, lawyers and other advisors, the Lender and Wells Fargo Bank may share any and all information they may have in their possession regarding the Borrower and its Affiliates, and the Borrower waives any right of confidentiality it may have with respect to such sharing of information.

Section 8.11 Severability of Provisions. Any provision of this Agreement which is prohibited or unenforceable shall be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof.

Section 8.12 Headings. Article, Section and subsection headings in this Agreement are included herein for convenience of reference only and shall not constitute a part of this Agreement for any other purpose.

Section 8.13 Governing Law; Jurisdiction, Venue; Waiver of Jury Trial. The Loan Documents shall be governed by and construed in accordance with the substantive laws (other than conflict laws) of the State of New York. The parties hereto hereby (i) consent to the personal jurisdiction of the state and federal courts located in the State of New York in connection with any controversy related to this Agreement; (ii) waive any argument that venue in any such forum is not convenient; (iii) agree that any litigation initiated by the Lender or the Borrower in connection with this Agreement or the other Loan Documents may be venued in either the state or federal courts located in the City of New York, County of New York, New York; and (iv) agree that a final judgment in any such suit, action or proceeding shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by law.

THE BORROWER AND THE LENDER WAIVE ANY RIGHT TO TRIAL BY JURY IN ANY ACTION AT LAW OR IN EQUITY OR IN ANY OTHER PROCEEDING BASED ON OR PERTAINING TO THIS AGREEMENT OR ANY OTHER LOAN DOCUMENT.

[Signatures on next page]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their respective officers thereunto duly authorized as of the date first above written.

CDS BUSINESS SERVICES, INC.

60 Hempstead Ave, 6th Floor
West Hempstead, NY 11552

Telecopier: _____
Attention: _____
e-mail: _____

Wells Fargo Bank, National Association
Wells Fargo Business Credit
119 W. 40th Street, 16th Floor
Telecopier: (646) 728-3279
Attention: Account Manager – CDS
Business Services, Inc.

CDS BUSINESS SERVICES, INC.

By: /s/ LEONARD LEFF
LEONARD LEFF
Its PRESIDENT

WELLS FARGO BANK, NATIONAL ASSOCIATION

By: _____

Its Vice President

Table of Exhibits and Schedules

Exhibit A	Form of Revolving Note
Exhibit B	Compliance Certificate
Exhibit C	Premises
Schedule 5.1	Trade Names, Chief Executive Office, Principal Place of Business, and Locations of Collateral
Schedule 5.2	Capitalization and Organizational Chart
Schedule 5.5	Subsidiaries
Schedule 5.7	Litigation Matters
Schedule 5.11	Intellectual Property Disclosures
Schedule 5.14	Environmental Matters
Schedule 6.3	Permitted Liens
Schedule 6.4	Permitted Indebtedness and Guaranties

Exhibit A to Credit and Security Agreement

REVOLVING NOTE

\$10,000,000 _____, 2007

For value received, the undersigned, CDS BUSINESS SERVICES, INC., a Delaware corporation (the "Borrower"), hereby promises to pay to the order of WELLS FARGO BANK, NATIONAL ASSOCIATION (the "Lender"), acting through its Wells Fargo Business Credit operating division, on the Termination Date referenced in the Credit and Security Agreement dated the same date as this Revolving Note that was entered into by the Lender and the Borrower (as amended from time to time, the "Credit Agreement"), at Lender's office located at 119 W. 40th Street, New York, New York, or at any other place designated at any time by the holder hereof, in lawful money of the United States of America and in immediately available funds, the principal sum of Ten Million Dollars (\$10,000,000) or the aggregate unpaid principal amount of all Revolving Advances made by the Lender to the Borrower under the Credit Agreement, together with interest on the principal amount hereunder remaining unpaid from time to time, computed on the basis of the actual number of days elapsed and a 360-day year, from the date hereof until this Revolving Note is fully paid at the rate from time to time in effect under the Credit Agreement.

This Revolving Note is the Revolving Note referenced in the Credit Agreement, and is subject to the terms of the Credit Agreement, which provides, among other things, for acceleration hereof. Principal and interest due hereunder shall be payable as provided in the Credit Agreement, and this Revolving Note may be prepaid only in accordance with the terms of the Credit Agreement. This Revolving Note is secured, among other things, pursuant to the Credit Agreement and the Security Documents as therein defined, and may now or hereafter be secured by one or more other security agreements, mortgages, deeds of trust, assignments or other instruments or agreements.

The Borrower shall pay all costs of collection, including reasonable attorneys' fees and legal expenses if this Revolving Note is not paid when due, whether or not legal proceedings are commenced.

Presentment or other demand for payment, notice of dishonor and protest are expressly waived.

CDS BUSINESS SERVICES, INC.

By: _____
Name: _____
Its: President

Exhibit B to Credit and Security Agreement

COMPLIANCE CERTIFICATE

To: Wells Fargo Bank, National Association
Date: [_____, **200** ____]
Subject: Financial Statements

In accordance with our Credit and Security Agreement dated as of [_____, **2007**] (as amended from time to time, the "Credit Agreement"), attached are the financial statements of CDS Business Services, Inc. (the "Borrower") as of and for [_____, **200** ____] (the "Reporting Date") and the year-to-date period then ended (the "Current Financials"). All terms used in this certificate have the meanings given in the Credit Agreement.

I certify that the Current Financials have been prepared in accordance with GAAP, subject to year-end audit adjustments, and fairly present the Borrower's financial condition as of the date thereof.

I further hereby certify as follows: Events of Default. (Check one):

- ☐ The undersigned does not have knowledge of the occurrence of a Default or Event of Default under the Credit Agreement except as previously reported in writing to the Lender.
- ☐ The undersigned has knowledge of the occurrence of a Default or Event of Default under the Credit Agreement not previously reported in writing to the Lender and attached hereto is a statement of the facts with respect to thereto. The Borrower acknowledges that pursuant to Section 2.6(d) of the Credit Agreement, the Lender may impose the Default Rate at any time during the resulting Default Period.

Material Adverse Change in Litigation Matters of the Borrower. I further hereby certify as follows (check one):

- ☐ The undersigned has no knowledge of any material adverse change to the litigation exposure of the Borrower or any of its Affiliates or of any Guarantor.
- ☐ The undersigned has knowledge of material adverse changes to the litigation exposure of the Borrower or any of its Affiliates or of any Guarantor not previously disclosed in Schedule 5.7. Attached to this Certificate is a statement of the facts with respect thereto.

Financial Covenants. I further hereby certify as follows (check and complete each of the following):

1. Minimum Tangible Net Worth. Pursuant to Section 6.2(a) of the Credit Agreement, as of the Reporting Date, the Borrower's Tangible Net Worth was \$ _____, which ☐ satisfies ☐ does not satisfy the requirement that such amount be not less than the applicable amount set forth in the table below (numbers appearing between "< >" are negative) on the Reporting Date:

<u>Fiscal Quarter Ending</u>	<u>Minimum Tangible Net Worth</u>
March 31, 2007	\$ 2,236,000
June 30, 2007	\$ 1,936,000
September 30, 2007	\$ 1,696,000
December 31, 2007	\$ 1,496,000
March 31, 2008	\$ 1,266,000
June 30, 2008	\$ 1,117,000
September 30, 2008	\$ 1,041,000
December 31, 2008	\$ 1,066,000

2. Minimum Net Income. Pursuant to Section 6.2(b) of the Credit Agreement, as of the Reporting Date, the Borrower's Minimum Net Income (non-cumulative) was \$ _____, which ☐ satisfies ☐ does not satisfy the requirement that such amount be not less than applicable amount set forth in the table below (numbers appearing between "< >" are negative) on the Reporting Date:

<u>Fiscal Quarter Ending</u>	<u>Minimum Net Income</u>
March 31, 2007	<\$400,000>
June 30, 2007	<\$300,000>
September 30, 2007	<\$240,000>
December 31, 2007	<\$200,000>
March 31, 2008	<\$230,000>
June 30, 2008	<\$150,000>
September 30, 2008	<\$75,000>

<u>Fiscal Quarter Ending</u>	<u>Minimum Net Income</u>
December 31, 2008	\$ 25,000

3. Minimum Quarterly Net Cash Flow (non-cumulative). Pursuant to Section 6.2(c) of the Credit Agreement, as of the Reporting Date, the Borrower's Minimum Quarterly Net Cash Flow (non-cumulative) was \$ _____, which ☐ satisfies ☐ does not satisfy the requirement that such amount be not less than the applicable amount set forth in the table below (numbers appearing between "<>" are negative) on the Reporting Date:

<u>Quarter Ending</u>	<u>Minimum Net Cash Flow</u>
March 31, 2007	<\$268,000>
June 30, 2007	<\$173,000>
September 30, 2007	<\$113,000>
December 31, 2007	<\$73,000>
March 31, 2008	<\$103,000>
June 30, 2008	<\$22,000>
September 30, 2008	\$ 55,000
December 31, 2008	\$ 101,000

4. Capital Expenditures. The Borrower will not incur or contract to incur Capital Expenditures of more than \$300,000 in the aggregate during any fiscal year. For the fiscal year ending _____, Capital Expenditures were _____, of which _____ was financed, which ☐ is ☐ is not in compliance with Section 6.2(d) of the Credit Agreement

5. Salaries. As of the Reporting Date, the Borrower has not paid excessive or unreasonable salaries, bonuses, commissions, consultant fees or other compensation, or increased the salary, bonus, commissions, consultant fees or other compensation of any Director, Officer or consultant, or any member of their families, by more than ten percent (10%) over the amount paid in the Borrower's previous fiscal year, either individually or for all such persons in the aggregate, and has not paid any increase from any source other than profits earned in the year of payment, and as a consequence ☐ is ☐ is not in compliance with Section 6.8 of the Credit Agreement.

5. Minimum Availability. The Borrower shall maintain at all times a minimum Availability of not less than \$25,000. As of the Reporting Date, Availability was _____, which ☐ is ☐ is not in compliance with Section 6.2(e) of the Credit Agreement.

Attached hereto are all relevant facts in reasonable detail to evidence, and the computations of the financial covenants referred to above. These computations were made in accordance with GAAP.

CDS BUSINESS SERVICES, INC.

By: _____
Its Chief Financial Officer

Exhibit C to Credit and Security Agreement

PREMISES

The Premises referred to in the Credit and Security Agreement are legally described as follows:

60 Hempstead Avenue, 6th Floor, Hempstead, New York 11552

C-1

Schedule 5.1 to Credit and Security Agreement

**TRADE NAMES, CHIEF EXECUTIVE OFFICE, PRINCIPAL PLACE OF BUSINESS,
AND LOCATIONS OF COLLATERAL**

TRADE NAMES

myreceivables.com

Chief Executive Office/Principal Place of Business

60 Hempstead Avenue, 6th Floor, Hempstead, New York 11552]

Other Inventory and Equipment Locations

None

S-5.1-1

Schedule 5.2 to Credit and Security Agreement

Ownership Chart

CDS BUSINESS SERVICES, INC.

Common Stock Ledger

<u>Holder</u>	<u>Shares</u>
Leonard Leff	23,718,750
Hilda Leff	1,931,250
The Joe and Joanna Gitterman Grandchildren's Trust	7,955,950
Allyson Sage Leff	2,197,025
Hayden Sarah Leff	2,197,025
Tomstemark, L. P.	250,000
Richard L. Frankel	25,000
Robert E. Koe	100,000
Jeffrey Alan Campagna	25,000
Marc Abrams	50,000
Todd Sussman	25,000
Mark and Donna Sussman	25,000
John R. Panichello	100,000
Marc S. Goldberg	25,000

S-5.5-1

Schedule 5.5 to Credit and Security Agreement

Subsidiaries

None

S-5.5-2

Schedule 5.7 to Credit and Security Agreement

LITIGATION MATTERS IN EXCESS OF \$10,000.00

1. WNC Insurance Services, Inc. (“WNC”) v. CDS Business Services, Inc. – WNC and Borrower entered into a Provider Agreement whereby Borrower was to attempt to sell life insurance products created by WNC to business owners. WNC advanced \$330,000.00 to Borrower against future commissions and Borrower invested significant capital and resources to market WNC’s products. WNC has filed a Demand for Arbitration claiming that Borrower breached the Provider Agreement by not selling any of the foregoing products and requested the return of \$330,000.00. Borrower contends that the Provider Agreement does not set forth any performance criteria or time frames by which Borrower must perform under the agreement, nor does the Provider Agreement specifically required Borrower to return the advance in the event WNC’s products are not sold by Borrower.

2. Ruskin Moscou Faltischek P.C. (“Ruskin”) – Ruskin delivered written notice to Borrower dated February 15, 2007 demanding immediate payment of \$177,086.47 for legal fees claimed to be associated with professional services rendered by Ruskin on behalf of Borrower.

Schedule 5.11 to Credit and Security Agreement

Intellectual Property Disclosures

None

S-5.11-2

Schedule 5.14 to Credit and Security Agreement

ENVIRONMENTAL MATTERS

None

S-5.2-1

Schedule 6.3 to Credit and Security Agreement**PERMITTED LIENS**

<u>Creditor</u>	<u>Collateral</u>	<u>Jurisdiction</u>	<u>Filing Date</u>	<u>Filing No.</u>
Wilshire New York Partners V, LLC	All personal property	Delaware	1/11/07	2007-0137843
Wilshire New York Partners V, LLC	All personal property	New York	1/11/07	200701110028491
Wilshire New York Partners IV, LLC	All personal property	Delaware	1/11/07	2007-0137330
Wilshire New York Partners IV, LLC	All personal property	New York	1/11/07	200701110028504
Exponential of New York, LLC	All personal property	Delaware	Amendment filed 1/26/07 to assign initial statement	2007-0339613
Exponential of New York, LLC	All personal property	Delaware	Amendment filed 1/26/07 to assign initial statement	2007-0339829
Exponential of New York, LLC	All personal property	Delaware	Amendment filed 1/26/07 to assign initial statement	2007-0340041
Exponential of New York, LLC	All personal property	New York	Amendment filed 1/11/07 to assign initial statement	200701110028465

S-5.2-1

Schedule 6.4 to Credit and Security Agreement

Permitted Indebtedness and Guaranties

INDEBTEDNESS

<u>Creditor</u>	<u>Principal Amount</u>	<u>Maturity Date</u>	<u>Monthly Payment</u>	<u>Collateral</u>
Exponential of New York, LLC	To be determined post-closing	TBD	TBD	All personal property of Borrower
Wilshire New York Partners IV, LLC	\$750,000.00	12/31/09	Interest Only at 10% per annum	All personal property of Borrower.
Wilshire New York Partners V, LLC	\$1,300,000.00	12/31/09	Interest Only at 10% per annum	All personal property of Borrower

GUARANTIES

None

S-5.2-2

WAIVER UNDER CREDIT AND SECURITY AGREEMENT

THIS WAIVER UNDER CREDIT AND SECURITY AGREEMENT, dated as of August 1, 2007 (this **“Waiver”**), is made by and among WELLS FARGO BUSINESS CREDIT, an operating division of Wells Fargo Bank, N.A. (**“Lender”**), and CDS BUSINESS SERVICES, INC. a Delaware corporation (**“CDS”** or the **“Borrower”**).

WITNESSETH :

WHEREAS, Borrower and Lender are parties to that certain Credit and Security Agreement, dated as of February 27, 2007 (as it may be amended, restated, modified or supplemented from time to time, the **“Credit Agreement”** ; capitalized terms used herein but not otherwise defined shall have the meanings ascribed thereto in the Credit Agreement); and

WHEREAS, Borrower has requested that Lender waive certain Events of Default under the Credit Agreement, as more fully set forth herein, and Lender is agreeable to such request only on the terms and conditions set forth herein;

NOW, THEREFORE, in consideration of the premises, the covenants and agreements contained herein, and for other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, the parties, intending to be legally bound, do hereby agree as follows:

STATEMENT OF TERMS

1. Waiver of Defaults. Lender hereby waives the Events of Default arising solely out of: (a) Borrower’s failure to meet its minimum Tangible Net Worth covenant for the fiscal quarter ending March 31, 2007 and (b) Borrower’s restated FYE 12/31/06 financial statements that resulted in a material adverse change default under Section 7.1 (i) of the Credit and Security Agreement.

2. Representations and Warranties. To induce Lender to enter into this Waiver, Borrower and Guarantor hereby represent and warrant to Lender as follows: (a) each representation and warranty of such party set forth in the Credit Agreement is true and correct on and as of the date hereof after giving affect to this Waiver (except to the extent that any such representation or warranty expressly relates to a prior specific date or period in which case it is true and correct as of such prior date or period); (b) no Default or Event of Default has occurred and is continuing as of this date under the Credit Agreement after giving effect to this Waiver; (c) such party has the power and is duly authorized to enter into, deliver and perform this Waiver; and (d) this Waiver is the legal, valid and binding obligation of such party enforceable against it in accordance with its terms.

3. Conditions Precedent to Effectiveness of this Waiver. The effectiveness of this Waiver is subject to the fulfillment of the following conditions precedent:

(a) Lender shall have received one or more counterparts of this Waiver duly executed and delivered by Borrower;

(b) The Guarantor of the Obligations shall have consented to the execution, delivery and performance of this Waiver and all of the transactions contemplated hereby by signing one or more counterparts of this Waiver in the appropriate space indicated below and returning the same to Lender; and

(c) Lender shall have received a waiver fee of \$2,500.

4. Continuing Effect of Credit Agreement . This Waiver shall be limited precisely as drafted and shall not constitute a waiver of any Event of Default or a modification of any terms and conditions of the Credit Agreement other than as expressly set forth herein. The granting of the Waiver shall not impose or imply an obligation on Lender to grant a waiver on any future occasion.

5. Counterparts. This Waiver may be executed in multiple counterparts, each of which shall be deemed to be an original and all of which when taken together shall constitute one and the same instrument. Any signature delivered by a party via facsimile shall be deemed to be an original signature hereto.

6. Governing Law. THIS WAIVER SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE INTERNAL LAWS OF THE STATE OF NEW YORK APPLICABLE TO CONTRACTS MADE AND PERFORMED IN SUCH STATE WITHOUT REGARD TO THE PRINCIPLES THEREOF REGARDING CONFLICTS OF LAWS.

IN WITNESS WHEREOF, the parties hereto have caused this Waiver to be duly executed and delivered as of the day and year first specified above.

WELLS FARGO BUSINESS CREDIT

By: /s/ Regina McCluskey

Name: Regina McCluskey

Title: Vice President

CDS BUSINESS SERVICES, INC., a Delaware corporation

By: /s/ Leonard Leff

Name: Leonard Leff

Title: President

ATTACHMENT A:
Revised Tangible Net Worth Covenants

The undersigned Guarantor does hereby consent to the execution, delivery and performance of the within and foregoing Waiver and confirms and reaffirms, without setoff, counterclaims, deduction or other claim of avoidance of any nature, the continuing effect of such Guarantor's guarantee of the Obligations after giving effect to the foregoing Waiver.

ACKNOWLEDGED and **AGREED** to as of the day and year first above set forth.

LEONARD LEFF

By: /s/ Leonard Leff
Name: Leonard Leff
Title: President

ATTACHMENT A

Fiscal Quarter Ending	Original TNW Covenant	Revised TNW Covenant
June 30, 2007	\$ 1,936,000	\$ 930,000
September 30, 2007	\$ 1,696,000	\$ 690,000
December 31, 2007	\$ 1,496,000	\$ 490,000
March 31, 2008	\$ 1,266,000	\$ 260,000
June 30, 2008	\$ 1,117,000	\$ 111,000
September 30, 2008	\$ 1,041,000	\$ 35,000
December 31, 2008	\$ 1,066,000	\$ 60,000

CERTIFICATION

I, Barry Sloane, Chief Executive Officer of Newtek Business Services, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Newtek Business Services, Inc. for the period ended June 30, 2007.
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures presented in this report our conclusions about the effectiveness of the disclosure controls and procedures; as of the end of the period covered by this report based on such evaluation; and
 - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's forth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 14, 2007

/s/ Barry Sloane
Barry Sloane
Chief Executive Officer

CERTIFICATION

I, Michael J. Holden, Chief Financial Officer of Newtek Business Services, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Newtek Business Services, Inc. for the period ended June 30, 2007.
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15a-15(f), for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 14, 2007

/s/ Michael J. Holden
Michael J. Holden
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q for the period ended June 30, 2007 (the "Report") of Newtek Business Services, Inc. (the "Company"), as filed with the Securities and Exchange Commission on the date hereof, Barry Sloane as Chief Executive Officer and Michael J. Holden as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906, that, to each officer's knowledge:

- (1) the Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Newtek.

/s/ Barry Sloane

Barry Sloane, Chief Executive Officer

/s/ Michael J. Holden

Michael J. Holden, Chief Financial Officer

Dated: August 14, 2007