



# **FORM 10-Q**

## **NEWTEK BUSINESS SERVICES INC – NEWT**

**Filed: May 15, 2007 (period: March 31, 2007)**

Quarterly report which provides a continuing view of a company's financial position

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## PART I

### – FINANCIAL INFORMATION

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

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended March 31, 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

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**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, 17<sup>th</sup> 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 May 9, 2007, there were 36,788,466 of the Company's Common Shares issued and outstanding.

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Item 1. Financial Statements

**NEWTEK BUSINESS SERVICES, INC., AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006**  
(In Thousands, except for Per Share Data)

	<u>2007</u>	<u>2006</u>
Revenue:		
Electronic payment processing	\$12,517	\$ 9,432
Web hosting	3,877	3,164
Interest income	1,492	1,413
Income from tax credits	1,301	1,258
Premium income	716	614
Servicing fee	444	499
Insurance commissions	238	244
Other income	1,224	522
Total revenue	<u>21,809</u>	<u>17,146</u>
Expenses:		
Electronic payment processing costs	8,970	6,907
Consulting, payroll and benefits	5,513	4,046
Interest	3,722	4,308
Professional fees	1,819	2,054
Depreciation and amortization	1,728	1,355
Insurance	813	863
Provision for loan losses	167	119
Other general and administrative costs	<u>3,267</u>	<u>2,359</u>
Total expenses	<u>25,999</u>	<u>22,011</u>
Loss from continuing operations before minority interest, benefit for income taxes, and discontinued operations	(4,190)	(4,865)
Minority interest	<u>124</u>	<u>233</u>
Loss from continuing operations before benefit for income taxes and discontinued operations	(4,066)	(4,632)
Benefit for income taxes	<u>1,372</u>	<u>1,607</u>
Loss from continuing operations before discontinued operations	(2,694)	(3,025)
Discontinued operations, net of taxes	<u>(205)</u>	<u>297</u>
Net loss	<u>\$ (2,899)</u>	<u>\$ (2,728)</u>
Weighted average common shares outstanding:		
Basic and diluted	35,651	34,834
Loss per share from continuing operations:		
Basic and diluted	\$ (0.07)	\$ (0.09)
(Loss) income per share from discontinued operations, net of taxes:		
Basic and diluted	<u>(0.01)</u>	<u>0.01</u>
Basic and diluted loss per share	<u>\$ (0.08)</u>	<u>\$ (0.08)</u>

See accompanying notes to these unaudited condensed consolidated financial statements.

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

	March 31, 2007 Unaudited	December 31, 2006 (Note 1)
<b>ASSETS</b>		
Cash and cash equivalents	\$ 29,866	\$ 26,685
Restricted cash	8,576	11,275
U.S. Treasury notes	4,684	5,016
Asset held for sale	—	1,530
Credits in lieu of cash	103,898	106,425
SBA loans held for investment (net of reserve for loan losses of \$2,448 and \$2,332, respectively)	28,609	27,746
Accounts receivable (net of allowance of \$275 and \$23, respectively)	5,935	1,568
SBA loans held for sale	4,308	1,786
Accrued interest receivable	531	519
Investments in qualified businesses—cost method investments	523	542
Investments in qualified businesses—held to maturity debt investments	2,699	5,301
Prepaid and structured insurance	16,807	17,497
Prepaid expenses and other assets (net of accumulated amortization of deferred financing costs of \$999 and \$832, respectively)	6,101	7,682
Servicing assets (net of accumulated amortization and allowances of \$2,318 and \$2,081, respectively)	3,110	2,991
Fixed assets (net of accumulated depreciation and amortization of \$4,661 and \$4,065, respectively)	4,630	4,458
Intangible assets (net of accumulated amortization of \$6,603 and \$5,919, respectively)	8,577	9,141
Goodwill	12,323	10,575
Total assets	<u>\$241,177</u>	<u>\$ 240,737</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities:		
Accounts payable and accrued expenses	\$ 9,646	\$ 8,509
Notes payable	11,453	10,651
Bank notes payable	20,556	16,391
Deferred revenue	2,046	2,761
Notes payable in credits in lieu of cash	85,556	86,332
Deferred tax liability	22,839	24,428
Total liabilities	<u>152,096</u>	<u>149,072</u>
Minority interest	<u>4,152</u>	<u>4,596</u>
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 35,835 and 35,479 not including 583 shares held in escrow and 473 shares held by affiliate)	717	710
Additional paid-in capital	55,701	54,949
Retained earnings	28,565	31,464
Treasury stock, at cost (32 shares at March 31, 2007)	(54)	(54)
Total shareholders' equity	<u>84,929</u>	<u>87,069</u>
Total liabilities and shareholders' equity	<u>\$241,177</u>	<u>\$ 240,737</u>

See accompanying notes to these unaudited condensed consolidated financial statements.

**NEWTEK BUSINESS SERVICES, INC., AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006**  
**(In Thousands)**

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:		
Net loss	\$(2,899)	\$(2,728 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of deferred loan origination fees, net	(88)	(37)
Income from tax credits	(1,301)	(1,258)
Deferred income taxes	(1,589)	(1,368)
Depreciation and amortization	1,728	1,415
Gain on sale of asset held for sale	(198)	—
Gain on redemption of U.S. Treasury note	(4)	—
Provision for loan losses	167	119
Accretion of interest income	(50)	(4)
Accretion of interest expense	3,063	3,343
Equity in earnings of investee	(229)	(95)
Stock-based compensation	165	158
Minority interest	(74)	(174)
Changes in assets and liabilities, net of the effect of business acquisitions:		
Originations of SBA loans held for sale	(9,116)	(7,879)
Proceeds from sale of SBA loans held for sale	6,594	6,269
Capitalized servicing asset	(355)	(258)
Prepaid and structured insurance	740	747
Prepaid expenses, accounts receivable, accrued interest receivable from bank and other assets	1,934	(1,070)
Restricted cash	(68)	—
Accounts payable, accrued expenses and deferred revenues	(2,555)	1,205
Net cash used in operating activities	<u>(4,135)</u>	<u>(1,615)</u>
Cash flows from investing activities:		
Investments in qualified businesses	—	(5,551)
Return of investments in qualified businesses	570	5,288
Purchase of fixed assets	(810)	(623)
Purchase of customer merchant accounts	(52)	—
Cash addition from acquired interests	233	—
SBA loans originated for investment, net	(2,686)	(2,407)
Payments received on SBA loans	1,744	2,222
Proceeds from sale of asset held for sale	1,572	—
Change in restricted cash	2,766	3,291
Proceeds from sale of U.S. Treasury notes, certificates of deposit	345	13,314
Other investments	—	(34)
Net cash provided by investing activities	<u>3,682</u>	<u>15,500</u>

**NEWTEK BUSINESS SERVICES, INC., AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006 (CONTINUED)**

	<u>2007</u>	<u>2006</u>
Cash flows from financing activities:		
Proceeds from notes payable	5,057	300
Repayments of notes payable	(4,266)	(4,024)
Payments for deferred financing costs	(165)	—
Change in restricted cash relating to CDS financing	2,050	—
Net proceeds on bank notes payable	907	1,792
Distributions to minority member	(370)	(45)
Net proceeds from option exercise	141	—
Other	280	—
Net cash provided by (used in) financing activities	<u>3,634</u>	<u>(1,977)</u>
Net increase in cash and cash equivalents	3,181	11,908
Cash and cash equivalents—beginning of period	<u>26,685</u>	<u>23,940</u>
Cash and cash equivalents—end of period	<u>\$29,866</u>	<u>\$ 35,848</u>
<b>Supplemental disclosure of cash flow activities:</b>		
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>\$ 3,828</u>	<u>\$ 4,265</u>
Effects of CDS Business Services, Inc. consolidation (excludes intercompany balances):		
Additions to assets:		
Cash	\$ 233	\$ —
Accounts receivable	4,311	—
Prepaid expenses and other assets	94	—
Total assets	<u>\$ 4,638</u>	<u>\$ —</u>
Additions to liabilities:		
Accounts payable and accrued expenses	\$ 3,127	\$ —
Notes payable	3,259	—
Total liabilities	<u>6,386</u>	<u>—</u>
Goodwill recognized	<u>\$ 1,748</u>	<u>\$ —</u>

See accompanying notes to these unaudited condensed consolidated financial statements.



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**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 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 to the small and medium-sized business market.

**Web Hosting:** CrystalTech Web Hosting, Inc., which offers shared and dedicated web hosting and related services to the small and medium-sized business market.

**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 all minority 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 amounts.

**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 March 31, 2007, 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 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.

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.

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## **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 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 March 31, 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 March 31, 2007 the Company had two share-based compensation plans. The compensation cost that has been charged against income for those plans was \$165,000 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 \$66,000.

A summary of stock option activity under the 2000 and 2003 Plans as of March 31, 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 March 31, 2007	1,407	\$ 3.22	4.89	\$ 943,000
Exercisable March 31, 2007	1,357	\$ 3.27	5.01	\$ 943,000

There were no options granted during the three months ended March 31, 2007 and 2006.

A summary of the status of Newtek's non-vested restricted shares as of March 31, 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	42	\$ 2.17
Vested	(22)	\$ 3.21
Forfeited	(1)	\$ 3.63
Non-vested at March 31, 2007	110	\$ 2.24

In the three months ended March 31, 2007, Newtek granted four employees an aggregate of 31,424 shares of restricted shares valued at \$65,000. The grants vest between 3 and 28 months. Additionally, the Company granted an officer 10,121 shares, valued at \$25,000 which was 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 March 31, 2007, there was \$160,000 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.

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 March 31, 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.

**NOTE 3 – DIVESTITURE:**

In October 2006, the Company decided to discontinue one of its businesses included in the “All other” segment, Phoenix Development Group, LLC, which provided services to, and reconstruction of, New Orleans, primarily in the form of temporary housing and related services. The results of this 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 three months ended March 31:

(In thousands):	<u>2007</u>	<u>2006</u>
<b>Total revenues</b>	<b>\$ 318</b>	<b>\$1,016</b>
<b>Total expenses</b>	<b>(628)</b>	<b>(481)</b>
<b>(Loss) income before provision for income taxes</b>	<b>(310)</b>	<b>535</b>
<b>Benefit (provision) for income taxes</b>	<b>105</b>	<b>(238)</b>
<b>(Loss) income from discontinued operations, net of taxes</b>	<b><u>\$ (205)</u></b>	<b><u>\$ 297</u></b>

The assets and liabilities of this business, which the Company had initiated plans to sell, but had not sold as of December 31, 2006, were classified as held for sale on the accompanying condensed consolidated balance sheet as of December 31, 2006.

The properties were sold in February and March 2007. Gross proceeds from the sales were \$1,084,000 and the gain on the sale was \$198,000.

**NOTE 4 – 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):	
<b>Cash</b>	<b>\$ 233</b>
<b>Restricted cash</b>	<b>2,050</b>
<b>Accounts receivable, net</b>	<b>4,311</b>
<b>Prepaid expenses and other assets</b>	<b>94</b>
<b>Intangible assets, net</b>	<b>800</b>
<b>Total assets</b>	<b><u>\$ 7,488</u></b>
<b>Accounts payable and accrued expenses</b>	<b>\$ 3,127</b>
<b>Notes payable</b>	<b>6,109</b>
<b>Total liabilities assumed</b>	<b><u>9,236</u></b>
<b>Goodwill recognized</b>	<b><u>\$ 1,748</u></b>

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 5 – 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.

#### NOTE 6 – INVESTMENTS IN QUALIFIED BUSINESSES:

##### HELD TO MATURITY DEBT INVESTMENTS—Summary (In thousands)

	<u>Total</u>
Principal outstanding at December 31, 2006	\$ 5,301
Return of principal	(552)
Consolidation of CDS pursuant to FIN 46R	(2,050)
Principal outstanding at March 31, 2007	<u>\$ 2,699</u>

##### COST INVESTMENTS—Summary (In thousands)

Total cost investments at December 31, 2006	\$ 542
Return of investments	(19)
Total cost investments at March 31, 2007	<u>\$ 523</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 March 31, 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.

#### NOTE 7 – SBA LOANS HELD FOR INVESTMENT:

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 three months ended March 31, 2007 (In thousands):

Balance at December 31, 2006	\$ 27,746
SBA loans originated for investment	2,880
Payments received	(1,744)
Provision for SBA loan losses	(167)
Discount on loan originations, net	(106)
Balance at March 31, 2007	<u>\$ 28,609</u>



Below is a summary of the activity in the reserve for loan losses balance for the three months ended March 31, 2007 (In thousands):

Balance at December 31, 2006	\$ 2,332
SBA loan loss provision	167
Recoveries	19
Loan charge-offs	(70)
Balance at March 31, 2007	<u>\$ 2,448</u>

Below is a summary of the activity in the SBA loans held for sale for the three months ended March 31, 2007 (In thousands):

Balance at December 31, 2006	\$ 1,786
Loan originations for sale	9,116
Loans sold	<u>(6,594)</u>
Balance at March 31, 2007	<u>\$ 4,308</u>

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 March 31, 2007 and December 31, 2006, net SBA loans receivable held for investment with adjustable interest rates amounted to \$27,564,000 and \$26,815,000, respectively.

For the three months ended March 31, 2007 and 2006, NSBF funded approximately \$11,800,000 and \$10,400,000 in loans and sold approximately \$6,600,000 and \$6,300,000 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 March 31, 2007 and December 31, 2006 amounted to \$0 and \$516,000, respectively.

At March 31, 2007 and December 31, 2006, total impaired non-accrual loans amounted to \$6,067,000 and \$5,293,000, respectively. For the three months ended March 31, 2007 and for the year ended December 31, 2006, the average balance of impaired non-accrual loans was \$5,369,000 and \$4,507,000, respectively. Approximately \$1,223,000 and \$1,036,000 of the allowance for loan losses were allocated against such impaired nonaccrual loans, respectively, 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:

(In thousands):	March 31, 2007	December 31, 2006
Due in one year or less	\$ 11	\$ 15
Due between one and five years	1,514	1,585
Due after five years	<u>31,288</u>	<u>30,127</u>
Total	32,813	31,727
Less : Allowance for loan losses	(2,448)	(2,332)
Less: Deferred origination fees, net	<u>(1,756)</u>	<u>(1,649)</u>
Balance (net)	<u>\$ 28,609</u>	<u>\$ 27,746</u>

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**NOTE 8 – 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 three months ended March 31, 2007 were as follows:

(In thousands):

Balance at December 31, 2006	\$3,252
Servicing assets capitalized	355
Servicing assets amortized	<u>(236)</u>
Balance at March 31, 2007	<u>3,371</u>
Reserve for impairment of servicing assets:	
Balance at December 31, 2006	(261)
Additions	<u>—</u>
Balance at March 31, 2007	<u>(261)</u>
Balance at March 31, 2007 (net of reserve)	<u>\$3,110</u>

The estimated fair value of capitalized servicing rights was \$3,110,000 and \$2,991,000 at March 31, 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 \$159,600,000 and \$163,277,000 as of March 31, 2007 and December 31, 2006, respectively.

**NOTE 9 – 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:

(In thousands except per share data):	Three Months Ended March 31,	
	2007	2006
Numerator:		
Numerator for basic and diluted EPS—loss from continuing operations	\$ (2,694)	\$ (3,025)
Numerator for basic and diluted EPS—(loss) income from discontinued operations	\$ (205)	\$ 297
Numerator for basic and diluted EPS—loss available to common shareholders	\$ (2,899)	\$ (2,728)
Denominator:		
Denominator for basic and diluted EPS—weighted average shares	35,651	34,834
Net EPS from continuing operations: Basic and diluted	\$ (0.07)	\$ (0.09)
Net EPS from discontinued operations: Basic and diluted	(0.01)	0.01
Net EPS: Basic and diluted	<u>\$ (0.08)</u>	<u>\$ (0.08)</u>

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

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Stock options and restricted stock	823	1,990
Warrants	216	216
Contingently issuable shares	583	861

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**NOTE 10 – 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 the other general and administrative costs 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.

(In thousands)

	For the three months ended March 31, 2007	For the three months ended March 31, 2006
<b>Third Party Revenue</b>		
Electronic payment processing	\$ 12,557	\$ 9,476
Web hosting	3,888	3,203
SBA lending	2,315	2,122
Capco	1,636	1,568
All other	1,519	875
Corporate activities	<u>1,126</u>	<u>1,263</u>
<b>Total reportable segments</b>	23,041	18,507
Eliminations	<u>(1,232)</u>	<u>(1,361)</u>
<b>Consolidated Total</b>	<u>\$ 21,809</u>	<u>\$ 17,146</u>
<b>Inter Segment Revenue</b>		
Electronic payment processing	\$ 112	\$ 84
Web hosting	46	15
SBA lending	—	—
Capco	501	320
All other	204	189
Corporate activities	<u>579</u>	<u>531</u>
<b>Total reportable segments</b>	1,442	1,139
Eliminations	<u>(1,442)</u>	<u>(1,139)</u>
<b>Consolidated Total</b>	<u>\$ —</u>	<u>\$ —</u>
<b>Income (loss) before benefit for income taxes and discontinued operations</b>		
Electronic payment processing	\$ 839	\$ 414
Web hosting	1,024	1,003
SBA lending	(7)	(56)
Capco	(3,539)	(4,142)
All other	(372)	(836)
Corporate activities	<u>(2,011)</u>	<u>(1,015)</u>
<b>Totals</b>	<u>\$ (4,066)</u>	<u>\$ (4,632)</u>
<b>Depreciation and amortization</b>		
Electronic payment processing	\$ 448	\$ 284
Web hosting	754	558
SBA lending	380	396
Capco	15	5
All other	71	73
Corporate activities	<u>60</u>	<u>39</u>
<b>Totals</b>	<u>\$ 1,728</u>	<u>\$ 1,355</u>

	As of March 31, 2007	As of December 31, 2006
<b>Identifiable assets</b>		
Electronic payment processing	\$ 12,758	\$ 12,302
Web hosting	14,584	14,687
SBA lending	42,410	39,028
Capco	141,323	146,992
All other	24,905	21,220
Corporate activities	<u>5,197</u>	<u>6,508</u>
<b>Consolidated total</b>	<u><u>\$241,177</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. 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 March 31, 2007, we had over 78,000 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, 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.

**The Company's reportable business segments are:**

**Electronic Payment Processing:** Marketing, credit card processing and check approval services to the small and medium-sized business market.

**Web Hosting:** CrystalTech Web Hosting, Inc., which offers shared and dedicated web hosting and related services to the small and medium-sized business market.

**SBA Lending:** Newtek Small Business Finance, Inc., a nationally licensed, U.S. Small Business Administration 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 our other segments, including interest income, Capco management fee income and corporate operations 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 March 31, 2007 and March 31, 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 \$4,663,000, or 27%, to \$21,809,000 for the three months ended March 31, 2007, from \$17,146,000 for the three months ended March 31, 2006 primarily due to the increase in revenues in the EPP and Web hosting segments of \$3,081,000 and \$685,000, 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 interest income by segment for the three months ended March 31:

(In thousands)	2007	2006	Change
Electronic payment processing	\$ 50	\$ 43	\$ 7
Web hosting	9	39	(30)
SBA lending	932	843	89
Capco	269	237	32
All other	197	203	(6)
Corporate activities	35	48	(13)
	<u>\$1,492</u>	<u>\$1,413</u>	<u>\$ 79</u>

Other income increased by \$702,000, or 134%, to \$1,224,000 for the three months ended March 31, 2007 from \$522,000 for the three months ended March 31, 2006 primarily due to the consolidation of CDS Business Services, Inc for the first time this quarter. 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 \$1,467,000, or 36%, to \$5,513,000 for the three months ended March 31, 2007 from \$4,046,000 for the three months ended March 31, 2006.

Changes in interest expense by segment are summarized as follows for the three months ended March 31:

(In thousands)	2007	2006	Change
Electronic payment processing	\$—	\$ —	\$ —
Web hosting	32	267	(235)
SBA lending	457	512	(55)
Capco	3,130	3,512	(382)
All other	64	—	64
Corporate activities	39	17	22
	<u>\$3,722</u>	<u>\$4,308</u>	<u>\$ (586)</u>

The decrease in Capco interest expense relates to the decrease in the principal outstanding on the notes payable – AI Credit from \$9,250,000 as of March 31, 2006 to \$5,919,000 as of March 31, 2007. The \$235,000 decrease in the web hosting segment is due to the reduced outstanding balance on the note payable – TICC from \$4,000,000 at March 31, 2006 to \$1,000,000 as of March 31, 2007. The decrease in SBA interest expense is attributable to the decrease in bank notes payable from \$23,080,000 at March 31, 2006 to \$19,623,000 at March 31, 2007.

Professional fees decreased by \$235,000, or 11%, to \$1,819,000 for the three months ended March 31, 2007 from \$2,054,000 for the three months ended March 31, 2006 primarily due to a decrease in audit fees.

Depreciation and amortization expense increased by \$373,000, or 28%, to \$1,728,000 for the three months ended March 31, 2007 from \$1,355,000 for the three months ended March 31, 2006. This is due to the purchase of \$2,771,000 of fixed assets during the twelve months ended December 31, 2006.



Insurance expense decreased by \$50,000, or 6%, to \$813,000 for the three months ended March 31, 2007 from \$863,000 for the three months ended March 31, 2006.

Other general and administrative costs (consisting of occupancy, selling, general and administrative) increased by \$908,000, or 38%, to \$3,267,000 for the three months ended March 31, 2007 from \$2,359,000 for the three months ended March 31, 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 tax, decreased by \$502,000, or 169% to a loss of \$205,000 for the three months ended March 31, 2007 from income of \$297,000 for the three months ended March 31, 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 \$698,000, to \$318,000 for the three months ended March 31, 2007 from \$1,016,000 for the three months ended March 31, 2006. This was offset by an increase in total expenses of \$156,000 to \$577,000 for the three months ended March 31, 2007 from \$422,000 for the three months ended March 31, 2006, an increase in minority interest by \$9,000, to \$50,000 in 2007 from \$59,000 in 2006, and an increase in the (provision) benefit for income taxes of \$343,000, to \$105,000 in 2007 from \$(238,000) in 2006.

The effective tax benefit for the three months ended March 31, 2007 and 2006 was 33% and 33%, 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 \$171,000, or 6%, to \$2,899,000 for the three months ended March 31, 2007 from \$2,728,000 for the three months ended March 31, 2006, due to the increase in revenue of \$4,663,000, offset by an increase in total expenses of \$3,998,000, and a decrease in minority interest of \$109,000, offset by a decrease in the tax benefit of \$235,000 and an decrease in discontinued operations of \$502,000.

#### Segment Results:

The results of the Company's reportable segments are discussed below.

#### Electronic Payment Processing

(In thousands):	For the three months ended March 31,		% Change
	2007	2006	
Revenue	\$ 12,557	\$ 9,476	33%
Expenses	(11,718)	(9,062)	29%
Income before provision for income taxes	\$ 839	\$ 414	103%

Revenues increased by \$3,081,000 to \$12,557,000 due to a \$3,089,000 increase in electronic payment processing revenue offset, in part, by a \$8,000 decrease in interest and other income. The \$3,089,000 increase in electronic payment processing revenue was due to a \$2,928,000 increase in organic growth and \$157,000 in revenue from merchant portfolios that were acquired. At March 31, 2007, we provided our payment services to over 12,500 customers across the United States, compared to 9,200 customers at March 31, 2006, an increase of 36%. Gross total processing volume increased by 38 % to \$583,000,000 for the three months ended March 31, 2007 from \$423,000,000 for the three months ended March 31, 2006.

Expenses increased by \$2,656,000 to \$11,718,000 for the three months ended March 31, 2007 from \$9,062,000 for the three months ended March 31, 2006, due to an increase in electronic payment processing direct costs of \$2,072,000 to \$8,968,000 for the three months ended March 31, 2007 from \$6,896,000 for the three months ended March 31, 2006, an increase of 30% which correlates to the significant increase in revenue, a \$321,000 increase in professional fees, which consist principally of residual payments to independent sales agents and offices, a \$163,000 increase in depreciation and amortization and a \$73,000 increase in consulting, payroll and benefit costs.

## **Web Hosting**

(In thousands):	For the three months ended March 31,		% Change
	2007	2006	
Revenue	\$ 3,888	\$ 3,203	21%
Expenses	(2,864)	(2,200)	30%
Income before provision for income taxes	<u>\$ 1,024</u>	<u>\$ 1,003</u>	2%

Revenue is derived primarily from monthly recurring fees from hosting dedicated and shared websites. Web hosting revenue increased by \$685,000, or 21%, to \$3,888,000 for the three months ended March 31, 2007 from \$3,203,000 for the three months ended March 31, 2006. At March 31, 2007 and 2006, CrystalTech was providing services to 60,000 and 48,000 accounts, respectively, an increase of 25%. 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 59,400, in 2007, from 48,000, in 2006. The average number of dedicated websites, which generate a higher monthly fee, increased 50%, to 1,800 per month in 2007, from 1,200 in 2006. The average number of shared websites increased 23% to 57,600, per month in 2007, from 46,800, in 2006.

The \$664,000 increase in expenses in 2007 compared with 2006 was primarily due to a \$277,000 increase in consulting, payroll and benefits, a \$196,000 increase in depreciation and amortization, and a \$474,000 increase in other expenses, offset, in part, by a \$235,000 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 the capital expenditure of \$498,000 primarily for additional servers. Other expenses increased primarily due to \$208,000 in additional software required for additional servers, a \$99,000 increase in rent and utilities and a \$51,000 increase in marketing costs.

## **SBA Lending**

(In thousands):	For the three months ended March 31,		% Change
	2007	2006	
Revenue	\$ 2,315	\$ 2,122	9%
Expenses	(2,322)	(2,178)	7%
Loss before benefit for income taxes	<u>\$ (7)</u>	<u>\$ (56)</u>	(88)%

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.

The increase in premium income was attributable to NSBF selling 25 guaranteed loans in the three months ended March 31, 2007, aggregating \$6,595,000 compared to 24 loans sold aggregating \$6,269,000 in the same period for the prior year. In addition, the Company implemented the accounting principals under FAS156 which resulted in an increase in the premium recognized, as compared with FAS140, on each loan sale. The premiums recognized in connection with these sales were \$716,000 for the three months ended March 31, 2007 compared with \$614,000 in the same period for the prior year.

Servicing fee income related to SBA loans decreased by \$55,000 to \$444,000 for the three months ended March 31, 2007 from \$499,000 for the three month period ended March 31, 2006. The decrease in servicing fee income was attributable to a decrease in the servicing portfolio year over year. The average portfolio in which we earned servicing fee income for the quarter ended March 31, 2007 was \$137,567,000 compared with \$149,730,000 at March 31, 2006.

Interest income increased by \$89,000 due to an increase in the average outstanding portfolio of \$1,400,000 as well as an increase in the prime rate from 7.50% to 8.25%.

Expenses increased by \$144,000 in 2007 compared to 2006, primarily due to an increase in the provision for loan losses on SBA loans as well as an increase in consulting payroll and benefits. The provision for loan losses increased by \$47,000 to \$166,000 for the three months ended March 31, 2007 from \$119,000 for the three months ended March 31, 2006. This increase was attributable to management establishing an additional provision in order to maintain its allowance for loan losses at a level which management believed adequately covered inherent losses in the existing loan portfolio. Consideration in this evaluation included past and current loss experience, current portfolio composition and the evaluation of real estate collateral as well as current economic conditions. Consulting, payroll and benefits increased by \$101,000 due to additional personnel added to service the increased referrals and borrower base.

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 21% of total loans held for investment as of March 31, 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 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.

## Capco

(In thousands):	For the three months ended March 31,		% Change
	2007	2006	
Revenue	\$ 1,636	\$ 1,568	4%
Expenses	(5,298)	(5,943)	(11)%
Minority interest	123	233	(47)%
Loss before benefit for income taxes	<u>\$(3,539)</u>	<u>\$(4,142)</u>	<u>(15)%</u>

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 increased by \$43,000 to \$1,301,000 for the three months ended March 31, 2007 from \$1,258,000 for the three months ended March 31, 2006. Income from tax credits for the three months ended March 31 are as follows:

(In thousands):	2007	2006
From investment percentage thresholds	\$ —	\$ —
From accretion of income from thresholds	1,301	1,258
Total	<u>\$1,301</u>	<u>\$1,258</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 March 31 are as follows:

(In thousands):	2007	2006
Accretion of interest expense	\$3,063	\$3,343
Amortization of prepaid insurance	740	747
Total	<u>\$3,803</u>	<u>\$4,090</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 March 31 is as follows:

(In thousands):	2007	2006
Non-cash loss	<u>\$(2,502)</u>	<u>\$(2,832)</u>

In addition, other interest relating to notes payable – AI Credit, totaling \$66,000 and \$118,000, was incurred in the three month periods ended March 31, 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 \$1,360,000, for the three month periods ended March 31, 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

(In thousands):	For the three months ended March 31,		% Change
	2007	2006	
Revenue	\$ 1,519	\$ 875	74%
Expenses	(1,892)	(1,711)	11%
Minority interest	1	—	100%
Loss before benefit for income taxes	<u>\$ (372)</u>	<u>\$ (836)</u>	(56)%

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.

The revenue increase of \$644,000 in 2007 as compared with 2006, is primarily due to the consolidation of CDS Business Services, Inc. for the first time, which generated \$550,000 of revenues for the quarter. Additionally, Exponential Business Development Co., Inc. had a one time gain on an investment of \$229,000 for the three months ended March 31, 2007 as compared to a one time gain of \$100,000 during the same period last year. Insurance commissions decreased by \$37,000, or 13%, to \$247,000 for the three months ended March 31, 2007 from \$284,000 for the three months ended March 31, 2006.

Loss before benefit for income taxes decreased by \$464,000 in 2007 to \$372,000 from \$836,000 in 2006 primarily due to the reduction of \$512,000 of losses incurred in 2006 from Where Eagles Fly, a Washington D.C. Capco investment, offset in part by a \$148,000 loss in 2007 from CDS Business Services, Inc.

#### Corporate activities

(In thousands):	For the three months ended March 31,		% Change
	2007	2006	
Revenue	\$ 1,126	\$ 1,263	(11)%
Expenses	(3,137)	(2,278)	38%
Loss before benefit for income taxes	<u>\$ (2,011)</u>	<u>\$ (1,015)</u>	98%

Revenue is derived primarily from management fees earned from the Capcos, which amount to 2.5% of certified capital. Management fee revenue totaled \$1,086,000 and \$1,214,000 for the three month period ended March 31 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 \$128,000 in 2007 as compared with 2006 is due 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.

The \$859,000 increase in expenses in 2007 as compared to 2006 was primarily due to a \$687,000 increase in consulting, payroll, and benefits, a \$443,000 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 \$187,000 decrease in professional fees.

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 three months ended March 31, 2007 (In thousands)**

<b>Business Services Segments</b>						<b>Total Business Services Segments</b>	<b>CAPCO Segment</b>	<b>Eliminations</b>	<b>Total</b>
<b>SBA Lending</b>	<b>Electronic Payment Processing</b>	<b>Web Hosting</b>	<b>All Other</b>	<b>Corporate Activities</b>					
<u>\$2,315</u>	<u>\$ 12,557</u>	<u>\$3,888</u>	<u>\$ 1,519</u>	<u>\$ 1,126</u>	Net Revenue	<u>\$21,405</u>	<u>\$ 1,636</u>	<u>\$ (1,232)</u>	<u>\$21,809</u>
<u>2,322</u>	<u>11,718</u>	<u>2,864</u>	<u>1,891</u>	<u>3,137</u>	Total Expenses and minority interest	<u>21,932</u>	<u>5,175</u>	<u>(1,232)</u>	<u>25,875</u>
(7)	839	1,024	(372)	(2,011)	Income (loss) before (provision) benefit for income taxes and discontinued operations	(527)	(3,539)	—	(4,066)
<u>—</u>	<u>(291)</u>	<u>(507)</u>	<u>54</u>	<u>751</u>	(Provision) benefit for income taxes	<u>7</u>	<u>1,365</u>	<u>—</u>	<u>1,372</u>
(7)	548	517	(318)	(1,260)	Income (loss) before discontinued operations	(520)	(2,174)	—	(2,694)
<u>—</u>	<u>—</u>	<u>—</u>	<u>(205)</u>	<u>—</u>	Discontinued operations, net of tax	<u>(205)</u>	<u>—</u>	<u>—</u>	<u>(205)</u>
<u>(7)</u>	<u>548</u>	<u>517</u>	<u>(523)</u>	<u>(1,260)</u>	Net income (loss)	<u>(725)</u>	<u>(2,174)</u>	<u>—</u>	<u>(2,899)</u>
Non-Cash:									
—	—	—	—	—	Income from tax credits	—	(1,301)	—	(1,301)
379	448	754	71	60	Depreciation and amortization	1,712	15	—	1,727
—	—	—	—	—	Accretion of interest expense	—	3,063	—	3,063
—	291	395	(159)	(751)	Deferred income taxes	(224)	(1,365)	—	(1,589)
167	—	—	—	—	Provision for loan losses	167	—	—	167
(355)	—	—	—	—	Capitalization of servicing assets	(355)	—	—	(355)
(88)	—	3	(382)	162	Other non-cash – net	(305)	(173)	—	(478)
Change in assets and liabilities:									
(2,522)	—	—	—	—	SBA loans originated over proceeds from sale of SBA loans	(2,522)	—	—	(2,522)
—	—	—	—	—	Prepaid insurance	—	740	—	740
(68)	—	—	—	—	Restricted cash change	(68)	—	—	(68)
506	(616)	(276)	(216)	580	Other – net	(22)	(598)	—	(620)
<u>\$(1,988)</u>	<u>\$ 671</u>	<u>\$1,393</u>	<u>\$(1,209)</u>	<u>\$ (1,209)</u>	Net cash provided by (used in) operations	<u>\$ (2,342)</u>	<u>\$(1,793)</u>	<u>\$ —</u>	<u>\$ (4,135)</u>

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 Three Months Ended March 31,	
	2007	2006
Net cash used in operating activities	\$ (4,135 )	\$ (1,615 )
Net cash provided by investing activities	3,682	15,500
Net cash (used in) provided by financing activities	3,634	(1,977 )
Net increase in cash and cash equivalents	3,181	11,908
Cash and cash equivalents, beginning of period	26,685	23,940
Cash and cash equivalents, end of period	<u>\$ 29,866</u>	<u>\$ 35,848</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 March 31, 2007, our unused sources of liquidity consisted of unrestricted cash and cash equivalents of \$29,866,000 and \$3,950,000 available through the lending facility.

In addition, the Company held \$4,684,000 in U.S. Treasury Notes which are classified as held for sale and could be converted to cash and cash equivalents. Restricted cash totaling \$8,576,000 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 \$810,000 in fixed assets primarily to support increased customers in our web hosting segment and to acquire \$52,000 in customer merchant accounts. A net increase in the unguaranteed portion of SBA loans used \$942,000. We also received net proceeds of \$2,766,000 through a reduction in restricted cash held by our Capcos, and received proceeds of \$1,572,000 from the sale of asset held for sale.

Net cash provided by financing activities primarily includes net proceeds on notes payable of \$791,000 used to finance CDS activities, net proceeds on bank notes payable of \$907,000, 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 do not believe there are any new Capco programs currently being formed and as such are not anticipating any cash flow from new Capco programs for the foreseeable future.

We believe our operating cash flow, 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.

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**Item 3. Quantitative and Qualitative Disclosure 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 \$19,623,000 at March 31, 2007 outstanding on the GE line of credit. 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 first 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 \$43,126,000 and \$42,976,000 as of March 31, 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 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.

On January 26, 2007, the Company settled a lawsuit brought by a former employee and in connection with such settlement, the Company issued 171,795 shares valued at \$344,000.

### Item 2. Unregistered Sale of Equity Securities and Use of Proceeds.

On January 26, 2007, in connection with a legal settlement, the Company issued 85,505 shares of unregistered common shares valued at \$171,010 to a former employee. The fair market value was determined using the fair value of the underlying common stock at the date of the stipulation of settlement. The shares were issued in reliance on Section 4(2) of the Securities Act of 1933, as amended.

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

Previously reported in the Company's quarterly report on form 10-Q for the quarter ended March 31, 2006.

### Item 6. Exhibits

<u>Exhibit No.</u>	<u>Description</u>
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.)
2.2	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.)
2.3	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.)
2.4	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.)
2.4.1	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.)
2.5	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.)
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 10K 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.)



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- 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 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.
  - 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.

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**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: May 15, 2007

By: /s/ Barry Sloane  
Barry Sloane  
Chairman of the Board, Chief Executive Officer and Secretary

Date: May 15, 2007

By: /s/ Michael J. Holden  
Michael J. Holden  
Chief Financial Officer and Treasurer

Date: May 15, 2007

By: /s/ Eyal Amsalem  
Eyal Amsalem  
Chief Accounting Officer and Controller

**i/o DATA CENTERS****LEASE AND MASTER SERVICES AGREEMENT****(SIGNATURE PAGE)**

AGREEMENT NO. \_\_\_\_\_

THIS LEASE AND MASTER SERVICES AGREEMENT (this "Agreement") is dated March 15, 2007 and is by and between IO Capital Princess, LLC, a Delaware limited liability company doing business as i/o Data Centers ("Lessor") and the lessee identified below ("Customer").

**AGREED:**

In consideration of the covenants and agreements set forth herein, Customer and Lessor hereby agree that:

- A. All capitalized terms herein shall have the meanings ascribed to them in Attachment B;
- B. Customer agrees to lease from Lessor the Customer Area and engage Lessor to provide (directly or through its designee) the Related Data Center Services;
- C. Lessor agrees to lease to Customer the Customer Area and, in connection with such lease, provide to Customer the Related Data Center Services;
- D. Customer agrees to pay for such lease and related services and to assume such other obligations as are set forth in this Agreement; and
- E. This Agreement, including all Attachments hereto listed below, which are incorporated herein by reference, constitutes the complete and exclusive agreement between the parties with respect to the subject matter hereof, and supersedes and replaces any and all prior or contemporaneous discussions, negotiations, understandings and agreements, written or oral, regarding such subject matter.

**IO CAPITAL PRINCESS, LLC****d/b/a i/o Data Centers**8521 East Princess Drive  
Scottsdale, Arizona 85255**Customer Name: CrystalTech Web Hosting Inc.****Address:** 1125 W. Pinnacle Peak Road  
Suite 103  
Phoenix, AZ 85027

By: IO CAPITAL, LLC, Manager

By:

By:

Printed Name:

Title:

Printed name:

Title:

Date: \_\_\_\_\_, 2007

Date: \_\_\_\_\_, 2007

This Lease and Master Services Agreement includes the following Attachments, and no others:

- |                                                   |                         |
|---------------------------------------------------|-------------------------|
| <input checked="" type="checkbox"/> Attachment A: | Lease Fees              |
| <input checked="" type="checkbox"/> Attachment B: | Terms and Conditions    |
| <input checked="" type="checkbox"/> Attachment C: | Rules and Regulations   |
| <input checked="" type="checkbox"/> Attachment D: | Service Level Agreement |

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**i/o DATA CENTERS**

**LEASE AND MASTER SERVICES AGREEMENT**

**ATTACHMENT B — TERMS AND CONDITIONS**

The following terms and conditions apply to the Agreement by and between Lessor and Customer:

**1. DEFINITIONS.** As used herein, the following terms and phrases shall have the definitions set forth below in this Section 1. Other terms and phrases are defined elsewhere throughout this Agreement.

- 1.1 “Agreement” means the i/o Data Services Lease Agreement, including the Signature Page, Attachment A, Attachment B, Attachment C and Attachment D thereto.
- 1.2 “Change Order” means a duly executed amendment to Attachment A.
- 1.3 “Commencement Date” means the inception date of this Agreement as specified on Attachment A (subject to Section 8.1).
- 1.4 “Conditioned Power” means the electrical service provided by Lessor to a Customer Area which is provisioned through one or more uninterruptible power supply (UPS) system(s) or a DC battery plant, and which is further supported by one or more standby diesel generator(s).
- 1.5 “Cross-Connection” means a physical cable connection to a network other than a network operated by Lessor.
- 1.6 “Customer” means the lessee identified on the Signature Page.
- 1.7 “Customer Area” means the portion of the Data Center identified in Attachment A that the Customer has the exclusive right to use and occupy hereunder for the placement of Customer Equipment.
- 1.8 “Customer’s Business” means the sale of products, provision of services and other activities or enterprise of Customer (including government, administration and non-for-profit activities).
- 1.9 “Customer Equipment” means Customer’s computer hardware, peripheral, and other tangible equipment registered in writing with Lessor by Customer, as amended from time to time, that Customer places in the Customer Area pursuant to this Agreement. All changes in Customer Equipment, including but not limited to installation and removal of Customer Equipment, must be registered by Customer with Lessor and approved by Lessor in writing in advance, which approval shall not be unreasonably withheld or delayed. As between Lessor and Customer, the parties acknowledge and agree that all Customer Equipment is owned by Customer.
- 1.10 “Customer Materials” means all software, data, information contained in documentation, and other information and intangibles used by Customer to operate, install, and/or maintain Customer’s Business through the Customer Equipment or provided to Lessor by Customer for such purposes or otherwise pursuant to this Agreement. As between Lessor and Customer, the parties acknowledge and agree that all Customer Materials are owned by Customer.
- 1.11 “Data Center” means that certain data center located at 8521 East Princess Drive, Scottsdale, Arizona.
- 1.12 “Initial Term” means the period of time commencing on the Commencement Date and expiring after the period of time specified on Attachment A elapses, unless earlier terminated as provided herein
- 1.13 “Installation Date” means the date that the Customer, or its designee, installs the Customer Equipment in the Customer Area.
- 1.14 “Law” means any applicable local, state, federal, foreign or international law, rule, regulation, ordinance or the like.
- 1.15 “Lease Fees” means the lease fees and related charges which Customer is obligated to pay Lessor pursuant to Section 3 of this Agreement and as are specified on Attachment A to this Agreement and any Change Orders signed by Customer.
- 1.16 “Lessor Group” means, collectively, Lessor, IO Capital, LLC, and their respective directors, officers, shareholders, members, managers, employees, agents, constituent partners, affiliates, beneficiaries, trustees and representatives.

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- 1.17 “Mortgagee” means any mortgagee or beneficiary or any lessor of a ground or underlying lease with respect to any Security Document.
- 1.18 “Related Data Center Services” means the services to be provided (in connection with the lease by Lessor to Customer of the Customer Area) by Lessor (or Service Provider) to Customer under this Agreement as expressly set forth in Attachment A, as amended from time to time by the mutual agreement of the parties.
- 1.19 “Representatives” means the individuals identified and authorized by Customer to have access to the Customer Area in accordance with this Agreement. All Representatives must be registered with Lessor. Representatives may be changed by Customer from time to time only by advance written notice, of at least one business day, to Lessor.
- 1.20 “Rules and Regulations” means the general rules and regulations issued by Lessor relating to its provision of Related Data Center Services to its lessees, the current version of which is attached as Attachment C and which may be modified by Lessor from time to time.
- 1.21 “Security Deposit” means the amount provided by Customer to Lessor to secure its payment obligations under this Agreement.
- 1.22 “Security Document” means (i) any ground lease or underlying lease which may now exist or hereafter be executed affecting the Data Center or any portion thereof; (ii) the lien of any mortgage or deed of trust which may now exist or hereafter be executed affecting the Data Center or any portion thereof; (iii) any past and future advance made under any such mortgage or deed of trust; and (iv) any renewal, modification, replacement and extension of any such ground lease, master lease, mortgage or deed of trust.
- 1.23 “Service Provider” means the party designated by Lessor to perform any of the Related Data Center Services.
- 1.24 “Term” means the Initial Term hereof and any Renewal Term (as defined in Section 8.1 below).
- 1.25 “Transaction Documents” means, collectively, this Agreement together with any attachments, exhibits, riders, amendments, or addenda to this Agreement.

## **2. LEASE; DATA CENTER RESPONSIBILITIES AND SERVICES.**

Subject to the terms and conditions of this Agreement, including but not limited to Customer’s timely payment to Lessor of all fees specified in this Agreement, Lessor will lease to Customer the Customer Area to use and occupy on an exclusive basis for the purposes set forth herein and will provide to Customer the Related Data Center Services as described Attachment A and in accordance with the terms and conditions of this Agreement.

2.1 Lease. In consideration of the fees and charges specified in the Agreement and subject to the terms and conditions hereof, Lessor hereby leases to Customer the Customer Area to use and occupy on an exclusive basis solely for the installation, operation and maintenance of the Customer Equipment. Customer has inspected the Customer Area and the Data Center and accepts them in their “as is where is” condition.

2.2 Responsibilities. Customer shall be responsible for procuring all items and performing all tasks, responsibilities and services not expressly delegated to Lessor in this Agreement (collectively, the “Responsibilities”). Without limiting the generality of the foregoing, it is the Customer’s responsibility to (a) install, rack, stack and otherwise deploy the Customer Equipment into the Customer Area in a manner consistent with this Agreement, (b) label all Customer Equipment, cables and other elements within the Customer Area in a clear and easily identifiable manner, (c) obtain, document and pay for any rights which may be needed to provision the Related Data Center Services (and/or related equipment) at premises owned, leased, occupied or otherwise used by Customer, including without limitation, all rights of entry, roof rights, cable access rights, riser rights, and other building access rights and (d) timely provide the following documents for Lessor’s review and approval prior to the installation of Customer’s Equipment: (i) Network Diagram (if requested by Lessor); (ii) IP Address/Space Justification; (iii) Equipment List; (iv) Escalation Procedures, (v) Billing and Key Contacts List; (vi) Access List and (vii) such other documents as Lessor may reasonably request. Except as specifically provided in this Agreement, Customer assumes the full and sole responsibility for the condition, operation, repair, replacement, maintenance and management of the Customer Area. Customer, at Customer’s sole cost and expense, shall keep and maintain the Customer Area (including, but not limited to, all non-structural interior portions, systems and equipment; interior surfaces of exterior walls; partitions and ceilings; and interior electrical, lighting and plumbing fixtures) in good order, condition and repair, reasonable wear and tear excepted. Customer shall keep the Customer Area in a neat and sanitary condition and will not commit any nuisance or waste in, on or about the Customer Area or the Data Center. Customer’s repairs shall be at least equal in quality and workmanship to the original work and Customer shall make the repairs in accordance with all Laws. Customer waives the benefit of any Law permitting Customer to make repairs at Lessor’s expense. In the event Customer fails to timely perform any of the Responsibilities, in addition to any other rights or remedies available to Lessor under this Agreement and under Law, Lessor shall have the right but not the obligation to perform such Responsibilities on Customer’s behalf and recover from Customer, upon demand, all amounts expended by Lessor in such performance, plus fifteen percent (15%) of all such amounts for handling, supervision and overhead expenses.

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### 2.3 Remote Assistance Services.

(a) Remote Assistance. Customer may, from time to time, request performance of certain services with respect to the Customer Equipment located in the Customer Area that are performed with “eyes,” “ears” and “fingers,” but without the involvement of any installation of new equipment or any troubleshooting, diagnostics, systems access or login, testing or heavy physical labor (collectively, “Remote Assistance Services”). Examples of Remote Assistance Services include the following:

- (i) pushing buttons, and/or keypads;
- (ii) physical switching of a toggle switch;
- (iii) setting switches on a card mounted dip switch;
- (iv) power cycling equipment (turning power on and/or off);
- (v) remote visual observations and/or verbal reports to Customer on its specific collocation cabinet(s) for environment status, display lights, or terminal display information; and
- (vi) re-seating or replacement of existing or Customer provided hardware elements (e.g., circuit cards and drives).

(b) Instructions. Customer is required to provide clear, specific and detailed instructions with respect to the Remote Assistance Services requested. Neither Lessor nor the applicable Service Provider, or any of their respective personnel are required to act on directions that they reasonably believe are unclear or incomplete. The personnel of Lessor or of the applicable Service Provider, are not expected or required to make judgments or exercise discretion with respect to requested Remote Assistance Services, nor to make recommendations as to courses of action to follow. If personnel of Lessor or of the applicable Service Provider either do not understand an instruction, or believe it to be incorrect or inadvisable, such personnel may elect in their sole discretion not to proceed with such task until their concerns have been resolved; provided that such personnel explain such concerns to Customer. In addition to the limitations on liability set forth in the Agreement, neither Lessor nor the applicable Service Provider, nor any of their respective personnel or agents will have any liability for any damages arising out of their actions in response to or failure to act on any Customer request for Remote Assistance Services unless such damages are the direct result of such parties’ gross negligence or intentional misconduct.

(c) Request Procedure. Each Customer request for Remote Assistance Services will require a separate initiation by Customer to the Lessor or to the applicable Service Provider, initially by telephone, followed by a physically or electronically signed request via fax, e-mail or other written method. If such request is received during regular business hours, Lessor or the applicable Service Provider, will use reasonable efforts to respond to Customer’s request for Remote Assistance Services within one hour of receipt of the request. If any such request is received outside of regular business hours for Lessor or the applicable Service Provider, as the case may be, Lessor or the applicable Service Provider, as the case may be, will use reasonable efforts to respond to Customer’s request for Remote Assistance Services within three (3) hours of receipt of the request. Customer’s requests shall be sent to NOC@iodatacenters.com, or to such other address as may be designated by Lessor or the applicable Service Provider by notice to Customer. The personnel of Lessor or of the applicable Service Provider, will call Customer to provide an explanation of the work performed once any requested Remote Assistance Services have been performed. Notwithstanding the foregoing, the parties acknowledge and agree that Lessor or the applicable Service Provider shall have the right to respond to requests for Remote Assistance Services in the manner and within the timeframe that Lessor or the applicable Service Provider deems reasonable and appropriate, in its sole but professional discretion. Additionally, the parties acknowledge and agree that the Remote Assistance Services provided by Lessor or the applicable Service Provider, are intended to be incidental to the Related Data Center Services and shall not unreasonably interfere with Lessor’s business operations. Although Remote Assistance Services are generally provided at no additional charge, in the event that Customer’s requests for Remote Assistance Services exceed that which is customary in the industry, as determined in the sole but reasonable discretion of Lessor or the applicable Service Provider, the parties shall negotiate in good faith to limit such requests and determine a mechanism for compensating Lessor for any additional requests made by Customer for Remote Assistance Services.

2.4 Maintenance of Data Center. Lessor will use its reasonable efforts to cause the Data Center to be maintained in efficient working order and in accordance with its written maintenance standards. Lessor will have sole responsibility for negotiating, executing and administering the contracts related to the operation, maintenance and repair of the Data Center. Should any condition exist that may impair the integrity of the Data Center, Lessor will initiate and co-ordinate planned maintenance, which may include disconnection of all or any part of the Data Center. Lessor will, to the extent reasonably practicable, give Customer seven (7) business days notice in writing (or such shorter period as may be reasonably necessary), prior to initiating a planned maintenance operation, of the timing, scope and costs of such planned maintenance operation. Lessor will use all reasonable efforts to conduct planned maintenance outages, if any, of the Data Center during the hours of 01:00 and 06:00 local time on Sunday.

2.5 Conditioned Power. Lessor shall deliver to Customer the amount of Conditioned Power set forth in Attachment A of this Agreement. Customer shall (a) comply with the applicable electrical code, and (b) utilize the manufacturer’s specifications to determine the proper power allocation for each item of equipment it deploys in the Data Center. Lessor’s standard twenty (20) amp 120v power strip is fused at fifteen (15) amps for safety and other purposes. Customer may replace such standard power strips only with UL listed equipment which is approved in advance by Lessor, such approval not to be unreasonably withheld. Lessor reserves the right to decline to provide Conditioned Power to the Customer Area in any manner which Lessor, in its reasonable discretion, deems to be unsafe, unreasonable, illegal or otherwise inconsistent with the electrical design of the Data Center.

**2.6 Cross-Connection.** Customer, at its cost and expense, may request that Lessor or the applicable Service Provider, complete cross connection(s) to or from third-party carriers within the Data Center (or which serve the Data Center), provided that Customer (a) provides to Lessor and the applicable Service Provider (i) a completed Cross Connect Request Form (available from the Lessor's operations center) at least thirty (30) days in advance of installation of any Cross-Connection(s), (ii) a description of the type of cable and size of Cross-Connection(s), (iii) the destination within the Customer Area of such Cross-Connection(s), (iv) the carrier providing such Cross-Connection(s) and (v) the applicable tracking or order number, and (b) agrees to pay Lessor or the applicable Service Provider, the fee for such Cross-Connection(s) as set forth on the Cross Connect Request Form. All points of interconnection, conduit and/or cable routes and other details shall be determined by Lessor in its sole discretion and shall belong to Lessor during and after the Term hereof. The responsibilities of Lessor or the applicable Service Provider, shall be to run and terminate a physical cable and test the cable to confirm continuity of the physical layer thereof. Customer shall be responsible for the circuit underlying such cross-connection, including the initial turn-up, integration, logical function and use thereof. Customer expressly recognizes that other than completing the Cross-Connection, neither Lessor nor the applicable Service Provider, has any responsibility whatsoever for the nature, performance, quality, integration, protocol, timeliness, utility or other features of circuit(s) provided by a third-party carrier or provider, which shall be governed solely by Customer's agreement(s) with such carrier or provider.

**2.7 IP Bandwidth.** If IP Bandwidth services are to be provided by Lessor or a Service Provider hereunder to Customer, the following terms and conditions shall apply:

(a) As used herein, IP Bandwidth means the internet protocol bandwidth provided by Lessor or a Service Provider, which features multi-homed connectivity from two or more upstream carriers, unless otherwise specified.

(b) In utilizing the IP Bandwidth, Customer agrees to follow all of Lessor's Rules and Regulations and Lessor's Acceptable Use Policy (as then in effect). The Acceptable Use Policy is available from the Lessor operations center and is posted at a link shown available at [www.iodatacenters.com](http://www.iodatacenters.com) or at such other address as may be designated by Lessor, or by request to [NOC@iodatacenters.com](mailto:NOC@iodatacenters.com). In addition, Customer agrees that Customer shall be responsible for the consumption of IP Bandwidth by Customer or Lessor or the applicable Service Provider which is attributable to Customer, or its IP space, including any consumption which occurs as a result of any denial of service attack, virus, Customer system or proxy compromise or otherwise. Customer shall secure its network and related elements at all times from attack, open proxy hijack and/or other abuse. Lessor (or the applicable Service Provider) uses an industry standard 95th percentile analysis to measure usage for IP Bandwidth service which allows Customer to burst beyond a given committed rate. Upon request, Lessor or the applicable Service Provider shall provide Customer with the data utilized by Lessor to conduct the 95th percentile analysis.

(c) Customer acknowledges and agrees that neither Lessor nor the applicable Service Provider exercises any control, of any kind whatsoever, over the content of the information passing through the Internet and Lessor (for itself and on behalf of any applicable Service Provider), disclaims any and all responsibility and liability as relates to the content of the information passing through the Internet.

(d) In the event of any termination of this Agreement, Customer, upon written notice to Lessor or the applicable Service Provider, and in connection with bona fide transition efforts, shall be entitled to retain control over the route of all IP addresses used by Customer during the preceding sixty (60) days for thirty (30) days following the expiration or termination of this Agreement, provided that the Customer has complied with all of Lessor's Rules and Regulations and Lessor's Acceptable Use Policy and agrees to continue to do so during the thirty (30) day transition period and is otherwise in compliance with this Agreement.

(e) Customer may resell IP Bandwidth services provided that (i) Customer shall have obtained all requisite approvals or authorizations as may be required by any applicable governmental entity or regulator, (ii) the obligations of Lessor or the applicable Service Provider hereunder shall be solely to Customer and not to any third party (iii) neither Lessor nor any applicable Service Provider shall have any obligation hereunder to support, supervise or otherwise assist parties other than Customer, and (iv) Customer shall be solely responsible for the actions, omissions and other conduct of any party to which it resells the IP Bandwidth services, including compliance with this Agreement.

**2.8 Colocation.** With the prior written consent of Lessor, not to be unreasonably withheld, Customer may physically colocate the equipment of a third-party (each, a "Colo User") at the Customer Area and utilize the Customer Area for the benefit of these Colo Users provided that Customer (i) registers in advance with Lessor the name, contact information and specific services utilized by such Colo User, (ii) ensures the compliance by such Colo User with this Agreement (including without limitation the Terms and Conditions and the Rules and Regulations), (iii) remains responsible and liable for the acts, omissions and other conduct of such Colo User, and (iv) does not solicit for any services which compete with Lessor's business of licensing space and providing Related Data Center Services (including without limitation colocation services) from any customer of Lessor or prospect which Customer learns about as a result of its business dealings with Lessor or access to the Data Center. Lessor will not permit Customer to provide any Related Data Center Services to a Colo User which has been terminated or refused service directly by Lessor. In consideration for the foregoing, upon expiration or termination of this Agreement for any reason (including failure by Customer to timely pay amounts due hereunder) or upon the request of any Colo User or other client of Customer, Lessor retains the right (but not obligation) to contract directly with that party for the provision of any Related

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Data Center Services. Customer specifically consents to the use by Lessor of the Colo User information which Customer registers with Lessor for this purpose. Under no circumstances shall Lessor be obligated to discontinue services to a Colo User which desires the continuation of such services.

### **3. FEES AND BILLING.**

3.1 Fees. Customer will timely pay all Lease Fees, fees, costs and other charges due hereunder as set forth in this Agreement and on Attachment A hereto, as such Attachment may be amended from time to time by the mutual agreement of the parties. Customer shall have the exclusive right to use the Customer Area for the purposes permitted hereunder, and Lessor shall provide to Customer (or shall cause a Service Provider to provide to Customer) the quantity and type of services specified on Attachment A, at the Lease Fees listed therein. Lessor may provide additional space in the Data Center and/or may provide (or may cause a Service Provider to provide) additional Related Data Center Services to Customer at prices upon which Lessor and Customer agree, as reflected in a Change Order. Notwithstanding the foregoing, Lessor reserves the right to pass along to Customer the actual, pro-rata increase in the cost of electricity, which increase will be applicable immediately and will be billed on a pass-through basis.

3.2 Expenses. Customer shall be solely responsible, and at Lessor's request will reimburse Lessor, for all costs and expenses reasonably incurred by Lessor in connection with this Agreement and the provision of the Related Data Center Services hereunder (the "Expenses"), provided such Expenses were pre-approved by Customer (such approval not to be unreasonably withheld, delayed or conditioned) or are otherwise authorized herein.

3.3 Billing and Payment Terms. Unless otherwise expressly provided in Attachment A, (i) Lease Fees (as defined in Attachment A) are due and payable in advance on the first day of each month of the Term and (ii) any applicable charges in addition to Lease Fees (including without limitation, Expenses) are due and payable within thirty (30) days of receipt from Lessor of an invoice reasonably describing the amount of such charges. In the event of a disputed invoice, Customer agrees to (i) notify Lessor in writing of such disputed amount within thirty (30) days of Customer's receipt of the subject invoice, (ii) pay all undisputed amounts in a timely fashion, (iii) make authorized personnel of Customer available to resolve the dispute and (iv) pay all disputed amounts that Customer is required to pay pursuant to a proper court order or award from any mutually submitted arbitration within ten (10) days from the date of such agreement or determination, with interest at 9% per annum. All amounts not timely and appropriately disputed shall be deemed final and not subject to further dispute. All payments will be made in U.S. dollars at Lessor's address set forth in this Agreement or at such other address, or to such other bank account, as Lessor may from time to time indicate by providing written notice to Customer. Any annual escalation in Lease Fees and/or other charges shall be effective upon each anniversary of the Commencement Date.

3.4 Delinquent Payments; Financial Condition. If Customer becomes delinquent in its payment obligations or other credit or financial requirements established by Lessor, or, if in the reasonable judgment of Lessor, Customer's credit becomes impaired, Lessor may, upon written notice to Customer, modify Customer's payment terms to require full payment before the provision of Related Data Center Services (or may use other means of securing Customer's payment obligations hereunder, including the establishment of, or increase to, the Security Deposit set forth in Section 3.5 below). Customer agrees to provide Lessor with such financial information as is reasonably necessary for Lessor to undertake such credit review analysis. Failure by Customer to timely respond to Lessor's request for evidence of credit worthiness shall allow Lessor to modify the payment terms to require full payment before the provision of Related Data Center Services, immediately upon notice.

3.5 Security Deposit. If Customer places a Security Deposit with Lessor pursuant to this Agreement, then the Security Deposit shall (a) be retained by Lessor for the benefit of Customer in its general account (i.e., not in a segregated account), (b) not bear interest for the account of Customer, (c) be available to Lessor to draw upon should any obligation of Customer to Lessor become past due (d) be promptly replaced by Customer in the event of such a draw event and (e) shall be refunded by Lessor no later than sixty (60) days following termination of this Agreement, assuming that Customer has paid all obligations to Lessor.

3.6 Taxes. All payments required by this Agreement are exclusive of all federal, state, municipal or other governmental excise, sales, privilege, transaction, value-added, use, personal property, and occupational taxes, excises, withholding taxes and obligations and other levies now in force or enacted in the future (including, without limitation, rental or other taxes assessed against the Lease Fees payable to Lessor hereunder), all of which Customer will solely be responsible for and will pay in full, except for taxes based on Lessor's net income. In the event Lessor is required to pay any such taxes, Lessor shall provide Customer with tax receipts or other evidence of payment and Customer shall promptly reimburse Lessor for such payment.

3.7 Collection Costs. In the event that Lessor institutes collection activities and/or litigation to collect sums owed by Customer, Lessor shall be entitled to its reasonable attorneys' fees' and costs incurred by Lessor in connection with the collection activities and/or litigation.



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#### **4. REPRESENTATIONS AND WARRANTIES: COVENANTS.**

##### **4.1 By Customer.**

(a) **Compliance with Law and Rules and Regulations.** Customer covenants, represents and warrants that in connection with the exercise of its rights and performance of its obligations under this Agreement, including without limitation, its performance of the Responsibilities and in connection with Customer's Business and all Customer Equipment and Customer Materials, Customer shall at all times comply with the terms and conditions of the Transaction Documents, the Rules and Regulations and Law, as well as all recorded covenants, conditions or restrictions affecting the Data Center and without disturbing or interfering with any other tenant or occupant of the Data Center.

(b) **Customer Equipment and Customer Materials.** Without limiting the generality of Section 4.1(a) above, Customer further covenants, represents and warrants that as of the date of this Agreement, it owns or has the legal right and authority, and will continue to own or maintain the legal right and authority during the Term, to place and use the Customer Equipment as contemplated by this Agreement, and to use, modify, transmit and distribute the Customer Materials without infringing, misappropriating or otherwise violating any intellectual property rights of any third party. Customer further represents and warrants that its placement, arrangement and use of the Customer Equipment in the Customer Area complies with the Customer Equipment and Customer Materials manufacturers' environmental and other specifications.

(c) **Customer's Business.** Without limiting the generality of Section 4.1(a) above, Customer further covenants, represents and warrants that it is familiar with Law applicable to Customer's Business and that, to the best of Customer's knowledge, Customer's Business does not as of the Commencement Date, and will not during the Term, violate any Law.

(d) **Customer's Inquiry.** Customer represents and warrants that (i) this Agreement has resulted solely from inquiries directed to Lessor that were solely and exclusively initiated by or on behalf of Customer in connection with identifying data center space in the ordinary course of Customer's business; and (ii) Customer was not at any point solicited by Lessor or any person acting on behalf of Lessor, directly or indirectly, in connection with the negotiation or entering into of this Agreement.

##### **4.2 By Lessor; Disclaimer of Warranties.**

(a) **Customer Area; Related Data Center Services.** Lessor represents and warrants that as of the Commencement Date it has the legal right and authority, and will continue to maintain the legal right and authority during the Term, to grant to Customer a lease for the use by Customer of the Customer Area for the purposes described hereunder and provide the Related Data Center Services to Customer as contemplated by this Agreement. Lessor shall comply with Law in its provision of the Related Data Center Services.

(b) **Service Level Agreement.** Lessor represents and warrants that it will provide the Related Data Center Services in accordance with the applicable service levels set forth in Attachment D attached hereto (the "**SLA**"). IN THE EVENT OF A BREACH OF THE SLA, CUSTOMER'S SOLE AND EXCLUSIVE REMEDY, AND LESSOR'S SOLE AND EXCLUSIVE LIABILITY, SHALL BE FOR LESSOR TO PROVIDE CUSTOMER THE APPLICABLE SERVICE LEVEL CREDIT(S) SET FORTH IN ATTACHMENT D.

(c) **DISCLAIMER OF WARRANTIES.** EXCEPT FOR THE EXPRESS WARRANTIES SET FORTH IN SUBSECTIONS (a) AND (b) ABOVE, ALL SERVICES PERFORMED AND SPACE MADE AVAILABLE BY LESSOR TO CUSTOMER HEREUNDER ARE PERFORMED, PROVIDED AND MADE AVAILABLE ON AN "AS IS" BASIS WITH NO WARRANTIES OF ANY KIND, AND CUSTOMER'S USE THEREOF IS AT CUSTOMER'S SOLE AND EXCLUSIVE RISK. LESSOR DOES NOT MAKE, AND HEREBY EXPRESSLY DISCLAIMS, ANY AND ALL OTHER EXPRESS AND/OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, WARRANTIES OF TENANTABILITY, HABITABILITY, MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, TITLE AND NON-INFRINGEMENT, AND ANY WARRANTIES ARISING FROM A COURSE OF DEALING, USAGE OR TRADE PRACTICE. WITHOUT LIMITING THE GENERALITY OF THE FOREGOING, LESSOR DOES NOT WARRANT THAT THE DATA CENTER SERVICES PROVIDED HEREUNDER WILL BE UNINTERRUPTED, ERROR-FREE OR COMPLETELY SECURE.

4.3 **Brokers.** Both Lessor and Customer represent that they have dealt with no other broker than as set forth in Attachment A in connection with the negotiation, execution and delivery of this Agreement (the "Broker"). If any person other than the Broker shall assert a claim to a finder's fee, brokerage commission or other compensation on account of alleged employment as finder or broker or performance of services as a finder or broker in connection with this transaction, the party through whom the finder or broker is claiming shall indemnify and hold the other party harmless from and against any such claim and all costs, expenses and liabilities incurred in connection with such claim or any action or proceeding brought thereon, including but not limited to attorneys' fees and court costs in defending such claim

#### **5. LIMITATIONS OF LIABILITY.**

##### **5.1 Disclaimer of Liability.**

(a) IN NO EVENT SHALL LESSOR BE LIABLE FOR ANY DAMAGE TO, OR LOSS OF, ANY CUSTOMER EQUIPMENT EXCEPT AS A RESULT OF LESSOR'S GROSS NEGLIGENCE OR WILFUL MISCONDUCT, AND THEN ONLY IN AN AMOUNT EQUAL TO THE THEN CURRENT VALUE OF SUCH CUSTOMER EQUIPMENT

(b) IN NO EVENT SHALL LESSOR BE LIABLE FOR ANY INCIDENTAL, PUNITIVE, INDIRECT, CONSEQUENTIAL, SPECIAL OR EXEMPLARY DAMAGES OF ANY KIND OR NATURE WHATSOEVER, INCLUDING WITHOUT LIMITATION, LOST CUSTOMER MATERIALS, LOST PROFITS, LOSS OF BUSINESS, LOSS OF REVENUES, LOSS OF DATA OR INTERRUPTION OR CORRUPTION OF DATA, EVEN IF LESSOR WAS ADVISED OF THE POSSIBILITY OF SUCH DAMAGES.

5.2 Maximum Liability. IN CONSIDERATION OF THE BENEFITS ACCRUING TO CUSTOMER UNDER THIS AGREEMENT AND NOTWITHSTANDING ANYTHING TO THE CONTRARY IN THE TRANSACTION DOCUMENTS, IT IS EXPRESSLY UNDERSTOOD AND AGREED BY AND BETWEEN THE PARTIES TO THIS AGREEMENT THAT: (a) NO PERSONAL LIABILITY OR PERSONAL RESPONSIBILITY OF ANY SORT WITH RESPECT TO ANY ACTUAL OR ALLEGED BREACH OR BREACHES BY OR ON THE PART OF LESSOR OF ANY REPRESENTATION, WARRANTY, COVENANT, UNDERTAKING OR AGREEMENT CONTAINED IN ANY OF THE TRANSACTION DOCUMENTS OR ANY MATTER RELATING TO CUSTOMER'S USE OR OCCUPANCY OF THE CUSTOMER AREA (COLLECTIVELY, THE "LESSOR UNDERTAKINGS") OR ANY ALLEGED BREACH THEREOF IS ASSUMED BY, OR SHALL AT ANY TIME BE ASSERTED OR ENFORCEABLE AGAINST, ANY MEMBER OF THE LESSOR GROUP OTHER THAN LESSOR; (b) THE RECOURSE OF CUSTOMER OR ITS SUCCESSORS OR ASSIGNS AGAINST LESSOR SHALL BE LIMITED TO, AND LESSOR'S MAXIMUM AGGREGATE LIABILITY RELATED TO OR IN CONNECTION WITH ANY CLAIM BY CUSTOMER RELATING TO THE LESSOR UNDERTAKINGS SHALL NOT EXCEED, THE TOTAL AMOUNT ACTUALLY PAID BY CUSTOMER TO LESSOR DURING THE TWELVE (12) MONTHS IMMEDIATELY PRECEDING THE MONTH IN WHICH THE CLAIM FIRST AROSE (OR THE TOTAL AMOUNT ACTUALLY PAID BY CUSTOMER TO LESSOR IF SUCH PAYMENTS HAVE BEEN MADE FOR LESS THAN TWELVE (12) MONTHS WHEN THE CLAIM FIRST AROSE); AND (c) CUSTOMER SHALL HAVE NO RECOURSE AGAINST ANY ASSETS OF ANY PERSON OTHER THAN LESSOR'S INTEREST IN THE DATA CENTER.

WITHOUT LIMITING THE FOREGOING, AND EXCEPT TO THE EXTENT PROVIDED IN SUBPART (b) OF THE PRECEDING SENTENCE, LESSOR WILL HAVE NO LIABILITY WHATSOEVER FOR ANY CLAIMS, LOSSES, ACTIONS, DAMAGES, SUITS, OR PROCEEDINGS RESULTING FROM ANY OF THE FOLLOWING OR FROM ANY EFFORTS OF LESSOR TO ADDRESS OR MITIGATE ANY OF THE FOLLOWING: (i) SECURITY BREACHES, INCLUDING WITHOUT LIMITATION EAVESDROPPING, THIRD PARTY ACCESS TO CUSTOMER DATA OR TO ASSIGNED COMPUTERS, THIRD PARTY ACCESS TO OR MISUSE OF PASSWORDS PROVIDED TO LESSOR, AND INTERCEPTION OF TRAFFIC SENT OR RECEIVED; (ii) RELEASE OR EXPOSURE, FOR ANY OTHER REASON, OF PERSONALLY IDENTIFIABLE INFORMATION OR OTHER PRIVATE DATA, INCLUDING DATA BELONGING TO CUSTOMER'S OWN CUSTOMERS AND OTHER USERS; (iii) DENIAL OF SERVICE ATTACKS, VIRUSES, WORMS, AND OTHER INTENTIONAL INTERFERENCE BY THIRD PARTIES; (iv) LOSS OF DATA OR LOSS OF ACCESS TO DATA; (v) ACTIONS OF THIRD PARTIES, INCLUDING WITHOUT LIMITATION AGENTS OR CONTRACTORS OF LESSOR; (vi) ACTIONS OF LESSOR EMPLOYEES OUTSIDE THE SCOPE OF THEIR EMPLOYMENT; OR (vii) MISTAKES, OMISSIONS, INTERRUPTIONS, DELETIONS OF FILES, ERRORS, DEFECTS, DELAYS IN OPERATION, OR OTHER FAILURES OF PERFORMANCE.

5.3 Waiver of Claims. Each party hereby waives its rights to bring any claim against the other party arising in any way from or relating in any way to this Agreement more than one (1) year after such claim first arises.

5.4 Applicability. THE LIMITATIONS SET FORTH IN THIS SECTION 5 WILL APPLY TO ANY AND ALL CLAIMS AND CAUSES OF ACTION WHATSOEVER, REGARDLESS OF WHETHER IN CONTRACT, TORT, STRICT LIABILITY OR OTHER THEORY.

5.5 Basis of the Bargain; Failure of Essential Purpose. Customer acknowledges that Lessor has set its prices and entered into this Agreement in reliance upon the limitations of liability and the disclaimers of warranties and damages set forth herein, and that the same form an essential basis of the bargain between the parties. The parties agree that the limitations and exclusions of liability and disclaimers of warranties and damages specified in this Agreement will survive and apply even if found to have failed of their essential purpose.

## **6. CUSTOMER INDEMNIFICATION.**

6.1 Obligation to Indemnify. Customer releases and will indemnify and hold Lessor, its affiliates, members, managers shareholders, officers, directors, employees, agents, representatives and licensees (collectively, the "Lessor Indemnified Parties") harmless from and against any and all costs, liabilities, judgments, actions, losses and expenses (including, but not limited to, reasonable attorneys' fees and fees of experts) arising out of any threatened or actual claim, suit, action, arbitration or proceeding made or brought against any Lessor Indemnified Party by any person, entity, governmental authority or other third party arising out of or relating to: (a) Customer's (or its Representative's or other invitee's) actual or alleged breach of any Transaction Document; (b) Customer's (or its Representative's or other invitee's) actual or alleged negligence or willful misconduct; and (c) the Responsibilities, Customer Equipment, Customer Materials, Customer's Business and/or the actions (or failure to act) of a Colo User or person to which Customer resells IP Bandwidth pursuant to Section 2.7(e), including without limitation claims of infringement of any trademark, copyright, patent, trade secrets or nonproprietary rights (including without limitation defamation, libel, violation of privacy or publicity), or any injury to or death of any person or damage to any property occurring upon the Customer Area, the Data Center or the land of which the Data Center is a part, in any case arising out of (or in connection with) the Responsibilities, Customer Equipment, Customer Materials, Customer's Business and/or a Colo User or person to which Customer resells IP Bandwidth.

**6.2 Indemnification Procedures.** Lessor or a Lessor Indemnified Party will provide Customer with (i) reasonably prompt notice in writing of any claim or action subject to indemnification hereunder (provided that failure to provide such notice does not relieve Customer of its indemnification obligations hereunder), (ii) information and reasonable assistance, at Customer's expense, as necessary or appropriate to defend or settle such claim or action, and (iii) full authority to defend or settle the claim or suit (provided that Customer shall not settle any proceeding in any matter which would impose any penalty or limitation on, or result in an admission of guilt or fault by or on the part of, any Lessor Indemnified Party without the written consent of such Lessor Indemnified Party). A Lessor Indemnified Party shall have the right to employ separate counsel and participate in the defense of any claim or action, at its own expense. If a Lessor Indemnified Party provides notice of an indemnification claim in accordance herewith and is not notified within ten (10) days that Customer intends to defend such claim, if Customer thereafter fails to vigorously defend such claim, or if a conflict of interest exists between Customer and a Lessor Indemnified Party, the affected Lessor Indemnified Party shall be entitled to defend, settle and/or compromise such claim and to be indemnified therefor as provided in Section 6.1.

## **7. INSURANCE.**

**7.1 By Customer.** Customer will keep in force and effect during the Term: (i) comprehensive general liability insurance in an amount not less than \$1 million per occurrence for bodily injury and property damage; (ii) employer's liability insurance in an amount not less than \$1 million per occurrence; and (iii) workers' compensation insurance in an amount not less than that required by Law. Customer shall insure the Customer Equipment. Customer also agrees that it and its agents (including contractors and subcontractors) will maintain other insurance at levels no less than those required by Law and customary in Customer's and its agents' industries. Prior to accessing the Customer Area and at such times thereafter as Lessor may reasonably request, Customer will furnish Lessor with certificates of insurance which evidence the minimum levels of insurance set forth herein, name Lessor as an additional insured, and include a waiver of subrogation by the insurer with respect to Lessor and its affiliates, members, managers, shareholders, officers, directors and employees. Failure by Customer to timely provide Lessor with such certificate shall entitle Lessor to prohibit Customer's access to the Customer Area until such certificate has been furnished to Lessor. As requested by Lessor, any underlying property owner or Mortgagee shall also be named as an additional insured. All such policies of insurance shall provide that the same shall not terminate or be canceled, nor the coverage modified, nor the limits changed without first giving thirty (30) days prior written notice to Lessor. No such cancellation, modification or change shall affect Customer's obligation to maintain the insurance coverage required hereby. All liability insurance policies shall be written on an "occurrence" policy form.

Customer, as a material part of the consideration to Lessor, hereby assumes all risk of damage to property or injury to persons, in, upon, or about the Customer Area from any cause, and Customer hereby waives all claims in respect thereof against Lessor, unless caused by gross negligence or willful action of Lessor, its agents or employees. Lessor shall not be liable for loss of or damage to any property by theft or otherwise, or for any injury or damage to persons or property resulting from fire, explosion, falling plaster, steam, gas, electricity, water or rain which may leak from any part of any building or from the pipes, appliances or plumbing works therein, or from the roof, street or subsurface, or from any other place resulting from dampness or any other cause whatsoever. Customer shall give immediate notice to Lessor of any fire, accident or defect discovered with the Customer Area or the Data Center. Customer acknowledges that it can protect itself against any or all of the foregoing risks by procuring appropriate insurance.

**7.2 By Lessor.** Lessor will keep in force and effect during the Term: (i) comprehensive general liability insurance in an amount not less than \$1 million per occurrence for bodily injury and property damage; and (ii) employer's liability insurance in an amount required by Law.

## **8. TERM AND TERMINATION.**

### **8.1 Term.**

(a) This Agreement will be effective for the Initial Term. This Agreement will automatically renew after the Initial Term for additional terms of one (1) year each (each, a "Renewal Term"), unless either party provides the other party with written notice that it will not renew the Agreement no later than ninety (90) days' prior to the end of the Initial Term or Renewal Term (as applicable), provided that the Lease Fees and other charges and costs owed during any Renewal Term shall be One Hundred and Five Percent (105%) of the Lease Fees and other charges that were billed immediately prior to such Renewal Term.

(b) Provided that no event of default exists at the time of Customer's exercise of the option or at the commencement of the Renewal Term provided pursuant to this Section 8.1(b), and that no event shall have occurred or state of facts exists which if continued uncured will, with the lapse of time or the delivery of notice or both, constitute an event of default, then Customer shall have, and is hereby granted, the option to extend the Initial Term for five (5) years. All the terms and conditions of this Agreement shall continue to apply during such three-year renewal term except that the Lease Fees and other charges and costs during each year of the five-year term thereof shall be increased annually, to One Hundred and Five Percent (105%) of the Lease Fees and other charges and costs that were billed in the immediately preceding year. If Customer desires to exercise its option to extend, it must give Lessor notice in writing of its intent to do so at least six, but no more than 12, months prior to the expiration of the Initial Term. If Customer exercises the renewal option set forth in this Section 8.1(b), the second sentence of Section 8.1(a) shall be suspended during such three-year renewal period.

(c) If delivery of possession of the Customer Area to Customer is delayed beyond the Commencement Date because of a delay in the substantial completion of construction of the Customer Area, if any, by Lessor, then, except as provided herein, this Agreement shall remain in full force and effect, Lessor shall not be liable to Customer for any damage occasioned by the delay, and the Commencement Date shall be changed to the date actual delivery of possession of the Customer Area to Customer is effected, with a corresponding abatement in Lease Fees unless the delay in the substantial completion of construction of the Customer Area by Lessor shall be due to special work, changes, alterations or additions required or made by Customer in the Customer Area, or shall be caused in whole or in part by Customer through the delay of Customer in submitting plans, supplying information, approving plans, specifications or estimates, giving authorizations or otherwise, or otherwise shall be caused in whole or in part by delay or default on the part of Customer. If Attachment A provides that delivery of the Customer Area shall be effected in more than one increment, the delivery dates and Customer's obligation to pay Lease Fees with respect to additional increments shall be as specified in Attachment A, with adjustment to any such event in the event of delay to be determined in the manner provided in the foregoing sentence.

## 8.2 Events of Default; Remedies.

(a) The following are events of default:

- (i) Customer's failure to pay Lease Fees or any other amount due under this Agreement as required pursuant to Section 3.3.
- (ii) Customer's failure to execute, acknowledge and return an estoppel certificate requested in accordance with Section 12.12(b) or any document requested in accordance with Section 12.13 within 10 days after Lessor gives notice of such request.
- (iii) Customer shall fail to vacate the Customer Area immediately upon termination of this Agreement, by lapse of time or otherwise;
- (iv) The leasehold interest of Customer shall be levied upon under execution or be attached by process of law or Customer shall fail to contest diligently the validity of any lien or claimed lien and give sufficient security to Lessor to insure payment thereof or shall fail to satisfy any judgment rendered thereon and have the same released, and such default shall continue for ten days after written notice thereof to Customer;
- (v) Customer shall become insolvent, have at any time a negative tangible net worth, admit in writing its inability to pay its debts generally as they become due, file a petition in bankruptcy or a petition to take advantage of any insolvency statute, make an assignment for the benefit of creditors, make a transfer in fraud of creditors, apply for or consent to the appointment of a receiver of itself or of the whole or any substantial part of its property, or file a petition or answer seeking reorganization or arrangement under the federal bankruptcy laws, as now in effect or hereafter amended, or any other applicable law or statute of the United States or any state thereof;
- (vi) A court of competent jurisdiction shall enter an order, judgment or decree adjudicating Customer a bankrupt, or appointing a receiver of Customer, or of the whole or any substantial part of its property, without the consent of Customer, or approving a petition filed against Customer seeking reorganization or arrangement of Customer under the bankruptcy laws of the United States, as now in effect or hereafter amended, or any state thereof, and such order, judgment or decree shall not be vacated or set aside or stayed within thirty (30) days from the date of entry thereof;
- (vii) Customer's use of the Customer Area and/or the Data Center threatens the availability, resiliency and/or routine operations of the Data Center, in Lessor's sole discretion; or
- (viii) Customer's failure to perform any other obligation under this Lease, including without limitation the Responsibilities, within 15 days after notice of nonperformance.

(b) Remedies. Upon the occurrence of an event of default, Lessor, at any time thereafter without further notice or demand, may exercise any one or more of the following remedies alternatively, concurrently or in succession:

- (i) Suspend the provision of some or all Related Data Center Services.
- (ii) Terminate Customer's right to possession of the Customer Area by legal process or otherwise, with or without terminating this Agreement, and retake exclusive possession of the Customer Area.
- (iii) From time to time relet all or portions of the Customer Area, using reasonable efforts to mitigate Lessor's damages. In connection with any reletting, Lessor may relet for a period less than or extending beyond the Term and may make alterations or improvements to the Customer Area without releasing Customer of any liability. Upon a reletting of all or substantially all of the

Customer Area, Lessor shall be entitled to recover all of its then prospective damages for the balance of the Term measured by the difference between amounts payable under this Lease and the anticipated net proceeds of reletting. In no event shall Customer be entitled to receive any amount representing the excess of avails of reletting over amounts payable hereunder.

(iv) From time to time recover accrued and unpaid Lease Fees and damages arising from Customer's breach of the Lease, regardless of whether the Lease has been terminated, together with applicable late charges and interest at the rate of 18% per annum or the highest lawful rate, whichever is less.

(v) Enforce the statutory landlord's lien on Customer's property.

(vi) Recover all reasonable attorneys' fees and other expenses incurred by Lessor in connection with enforcing this Lease, recovering possession, and collecting amounts owed.

(vii) Perform any obligation which Customer has failed to pay or do on Customer's behalf or remove equipment installed in contravention of the terms of this Lease and recover from Customer, upon demand, the entire amount expended by Lessor plus 15% of such amounts for handling, supervision, and overhead.

(viii) Terminate this Lease for any breach and recover from Customer all reasonable damages it may incur by reason of such breach, including the reasonable cost of recovering the Customer Area, and including the worth at the time of such termination of the excess, if any, of the amount of Lease Fees and charges equivalent to Lease Fees reserved in this Agreement for the remainder of the stated Term over the then reasonable rental value of the Customer Area for the remainder of the stated Term, all of which amounts shall be immediately due and payable from Customer to Lessor.

(ix) Notwithstanding anything in this Agreement to the contrary, to the extent not expressly prohibited by applicable Law, upon any event of default by Customer not cured within any applicable time for cure hereunder, Lessor may terminate this Agreement or Customer's right to possession and accelerate and declare that Lease Fees reserved for the remainder of the Term shall be immediately due and payable; provided, Lessor shall, after receiving payment of the same from Customer, be obligated to turn over to Customer any actual net re-letting proceeds thereafter received during the remainder of the Term, up to the amount so received from Customer pursuant to this provision.

(x) Pursue any other remedies available at law or in equity.

Pursuit of any of the foregoing remedies shall not preclude pursuit of any of the other remedies herein provided or any other remedies provided by Law (all such remedies being cumulative), nor shall pursuit of any remedy herein provided constitute a forfeiture or waiver of any Lease Fees due to Lessor hereunder or of any damages accruing to Lessor by reason of the violation of any of the terms, provisions and covenants herein contained. Lessor's acceptance of the payment of Lease Fees or other payments hereunder after the occurrence of an Event of Default shall not be construed as a waiver of such default, unless Lessor so notifies Customer in writing. Forbearance by Lessor in enforcing one or more of the remedies herein provided upon an Event of Default shall not be deemed or construed to constitute a waiver of such default or of Lessor's right to enforce any such remedies with respect to such default or any subsequent default. Nothing in this Section limits or prejudices Lessor's right to prove and obtain damages in an amount equal to the maximum amount allowed by Law, regardless whether such damages are greater than the amounts set forth in this Section.

(c) By Customer. Customer may terminate this Agreement (i) in the event Lessor breaches any material term or condition of this Agreement and fails to cure such breach within thirty (30) days of receiving written notice thereof; or (ii) in the event Lessor becomes the subject of a voluntary petition in bankruptcy or any voluntary proceeding relating to insolvency, receivership, liquidation, or composition for the benefit of creditors or the subject of an involuntary petition in bankruptcy or any involuntary proceeding relating to insolvency, receivership, liquidation or composition for the benefit of creditors which is not dismissed within sixty (60) days of filing.

**8.3 Effect of Termination.** Upon the effective date of any expiration or termination of this Agreement (and without limiting any of Lessor's remedies set forth elsewhere herein), and provided Customer has paid to Lessor all sums required hereunder, Customer shall have the right and obligation to remove from the Data Center all Customer Equipment, Customer Materials and any of its other property within the Data Center. All such Customer Equipment, Customer Materials and other property shall be removed by Customer within ten (10) days of such expiration or termination and the Customer shall return the Customer Area to Lessor in the same condition as it was on the Installation Date, normal wear and tear excepted. If Customer does not remove such property within such ten (10) day period of time, Lessor shall have the option, without limiting any other available rights or remedies, to (i) move any and all such property to secure storage and restore the Customer Area and charge Customer for the actual cost plus 15% of such removal, storage and restoration, and/or (ii) after providing Customer with an additional thirty (30) days advance written notice, liquidate the property in any reasonable manner and apply the proceeds to any amount owing from Customer to Lessor under this Agreement. Customer hereby grants Lessor a security interest in the Customer Equipment, Customer Materials and all of its other property within the Data Center to secure Customer's payment and performance of its obligations under this Agreement. Customer acknowledges that such security interest is perfected by Lessor's possession of such property, and further agrees to execute and deliver to Lessor financing statement(s) as deemed necessary or appropriate by Lessor. Customer hereby waives any statutory notices to vacate or quit the Customer Area upon expiration or termination of this Agreement.

8.4 Holding Over. Customer shall have no right to hold over after the expiration or termination of this Agreement without Lessor's consent. If Customer holds over after the expiration of this Agreement, Customer shall become a Customer from month to month only, upon all of the terms of this Agreement except that the amount of the Lease Fees shall be increased to an amount equal to the greater of (a) One hundred and Fifty Percent (150%) of the Lease Fees in effect immediately prior to the expiration for the first 90 days after the expiration of this Agreement and Two Hundred Percent (200%) thereafter or (b) the then fair market value of the Customer Area (which for this purpose shall be computed using recently executed agreements for space and related data center services in the same or a similar data center). Customer shall also pay to Lessor all damages sustained by Lessor resulting from retention of possession by Customer, including the loss of any proposed subsequent Customer for any portion of the Customer Area. The provisions of this Section shall not constitute a waiver by Lessor of any right of re-entry; nor shall receipt of any Lease Fees or any other act in apparent affirmation of the tenancy operate as a waiver of the right to terminate this Agreement for a breach of any of the terms, covenants, or obligations herein on Customer's part to be performed.

8.5 Survival. The rights and obligations of the parties in this Agreement that would by their nature or context be intended to survive the expiration or termination of this Agreement shall so survive, including without limitation the following provisions of this Agreement: Sections 3.5, 3.6, 3.7, 4.2(c), 5, 6, 8.2, 8.3, 8.4, 8.5, 9, 10 and 12.

## **9. CONFIDENTIAL INFORMATION; NONSOLICITATION.**

9.1 Confidential Information. Each party acknowledges that it will have access to certain confidential information and materials of the other party ("Confidential Information"). Confidential Information will include, but not be limited to, information regarding each party's business, plans, customers, technology, products, proprietary software, and customer information. Lessor specifically designates as Confidential Information its prices, rates, quotations and other financial information relating to this Agreement; and its written security procedures, maintenance manuals and other operational documents and procedures. Each party agrees that it will not use in any way, for its own account or the account of any third party, except as expressly permitted by this Agreement, nor disclose to any third party (except as required by Law or to that party's attorneys, accountants and other advisors as reasonably necessary), in verbal or other form, any of the other party's Confidential Information and will take reasonable precautions to protect the confidentiality of such information. Within thirty (30) days after expiration or termination of this Agreement for any reason, each party will return all Confidential Information of the other party in its possession, custody or control at the time of expiration or termination and will not make or retain any copies of such Confidential Information except as required to comply with any applicable legal, accounting, or administrative record keeping requirement.

9.2 Exceptions. Information will not be deemed Confidential Information hereunder if the receiving party can establish by reasonably competent evidence that such information: (a) is known to the receiving party prior to receipt from the disclosing party directly or indirectly from a source other than one having an obligation of confidentiality to the disclosing party; (b) becomes known (independently of disclosure by the disclosing party) to the receiving party directly or indirectly from a source other than one having an obligation of confidentiality to the disclosing party; (c) becomes publicly known or otherwise ceases to be secret or confidential, except through a breach of this Agreement by the receiving party; or (d) is independently developed by the receiving party without any use of or reliance upon the Confidential Information of the disclosing party.

9.3 Nonsolicitation of Personnel. Neither party hereto shall solicit, offer work to, employ, or contract with, directly or indirectly, on its own behalf or on behalf of a third party, any of the personnel of the other party hereto or their affiliates during the Term and for twelve (12) months thereafter. For purposes of this paragraph, "personnel" includes any individual or company a party employs or has employed or retained as an employee or independent contractor and which the party learns about as a result of its business dealings as described herein. Without limiting any other available remedy, a party in violation of this section 9.3 shall pay compensation to the other such party in the form of liquidated damages equal to the greater of six month's compensation either offered or paid to the personnel.

9.4 Remedies. Notwithstanding anything to the contrary in this Agreement, in the event of any breach of this Section 9, the non-breaching party will be entitled to seek injunctive relief; provided that no specification of a particular legal or equitable remedy shall be construed as a waiver, prohibition or limitation of any other remedy permitted by this Agreement.

## **10. ALTERATIONS; NO LIENS**

If, and to the extent, that Attachment A allows for or designates that work to the Customer Area be completed by Customer, then the following provisions of this Section 10 shall apply:

10.1 Customer's Work. Upon the Commencement Date, Lessor shall permit Customer to enter the Customer Area so that Customer, at Customer's sole cost and expense, may do such work as is explicitly described and permitted on Attachment A ("Customer's Work"). Such permission is conditioned upon (a) Customer and its agents, contractors, employees and invitees not interfering with work and operations conducted by Lessor and its designees and agents in the Data Center, if any, and shall be subject to all the terms of this Agreement, (b) Customer furnishing Lessor with evidence of such insurance as required of Customer under this Agreement and (c) Customer's

assuming full responsibility for any damages it causes. Lessor shall have the right to further condition, manage or revoke such rights to complete work if Customer fails to comply with the terms and conditions contained in this Section. Customer acknowledges and agrees that Lessor is not liable in any way for any injury, loss, or damage which may occur to Customer, its agents, contractors, employees, or invitees or work and installations made in the Customer Area, all of the same being at Customer's sole risk.

**10.2 Alterations and Approval.** Before commencement any of Customer's Work, Customer shall deliver to Lessor Customer's designated contractors, plans and specifications (the "Design Plans") showing Customer's Work, for Lessor's approval and consent, which shall not be unreasonably withheld or delayed, except that Lessor reserves the right to withhold consent in Lessor's sole discretion for Customer's Work affecting the structure, roof, safety, efficiency, or security of the Data Center, the Data Center systems ("Systems") and equipment ("Equipment") which affect the Customer Area and other space in the Data Center, or the appearance of the Customer Area from any common or public areas. The Design Plans shall comply with the Rules and Regulations and any applicable building standards or operational manual. At the time Customer submits the Design Plans to Lessor, Customer shall provide Lessor with notice of whether Customer's Work will involve or affect any Hazardous Materials, whether such materials are customary and usual based on standard industry practices, and all other reasonable details relating thereto. Lessor will promptly review the Design Plans and any changes thereto, making reasonable efforts to complete Lessor's review within five (5) business days after Lessor's receipt of the initial Design Plans, and will give Customer notice of Lessor's reasonable objections thereto, if any. Within five (5) days after receipt by Customer of Lessor's objections to the Design Plans (including omissions therefrom) Customer shall revise and resubmit the Design Plans for Lessor's review. The final Design Plans approved by Customer and Lessor are the "Final Plans". Any part of Customer's Work, including signs, but not including movable furniture, Customer's equipment and trade fixtures, shall, at Lessor's option, at the termination or expiration of this Lease or of Customer's right to possession, become a part of the realty and belong to Lessor. Neither review nor approval by Lessor of any item submitted by Customer shall constitute a representation or warranty by Lessor that any such item is complete or suitable for its intended purpose or in compliance with Law, it being expressly agreed by Customer that Lessor assumes no responsibility or liability therefor.

**10.3 Approval Conditions.** Lessor reserves the right to impose reasonable requirements as a condition of such consent or otherwise in connection with Customer's Work, including requirements that Customer: (a) use an authorized contractor and/or submit for Lessor's authorization and information the names, addresses and background information concerning the engineers, contractors, subcontractors and suppliers Customer proposes to use, (b) obtain and post permits, (c) provide a payment bond, in an amount and form reasonably satisfactory to Lessor, covering Customer's Work and/or such other guaranties of creditworthiness as Lessor may reasonably request, (d) submit conditional and final lien waivers in compliance with Arizona law for all architects, engineers, contractors, subcontractors, and suppliers performing Customer's Work, (e) permit Lessor or its representatives, upon reasonable notice, to inspect Customer's Work at reasonable times, (f) use a contractor specified by Lessor for all work affecting the Data Center fire detection system; and (g) comply with such other reasonable requirements as Lessor may impose concerning insurance coverage and the manner and times in which Customer's Work shall be done.

**10.4 Liens.** Customer shall pay all costs for Customer's Work when due. Customer shall keep the Data Center and the Customer Area free from any mechanic's, materialmen's, architect's, engineer's or similar liens or encumbrances, and any claims therefor, in connection with any of Customer's Work. Customer shall remove any claim, lien, or encumbrance of record relating to, caused by or resulting from Customer's Work, by bond or otherwise within 15 days after notice from Lessor. If Customer fails to do so, Lessor may pay the amount (or any portion thereof) or take such other action as Lessor deems necessary to remove such claim, lien, or encumbrance, without being responsible for investigating the validity thereof. The amount so paid and costs incurred by Lessor shall be deemed additional rent under this Lease payable within 30 days after demand, without limitation as to other remedies available to Lessor. Nothing contained in this Lease shall authorize Customer to do any act which subjects Lessor's title to, or any lender's interest in, the Data Center or the Customer Area or any part of it to any such claims, liens, or encumbrances, whether claimed pursuant to statute or other law or express or implied contract.

## **11. CASUALTY; CONDEMNATION.**

**11.1 Casualty.** Except as hereafter provided, if the Customer Area is wholly or partially destroyed or damaged by fire or other casualty, Lessor shall restore the Customer Area with reasonable diligence; provided, however, that Lessor shall have no obligation to restore improvements not originally provided by Lessor or to replace any of Customer's fixtures, furnishings, equipment, or personal property and Customer shall be responsible for refixturing the Customer Area and reinstalling its equipment. Lessor need not commence repairs until a substantial portion of the insurance proceeds are available and shall not be required to expend more than the actual insurance proceeds received. Proceeds of insurance payable with respect to a fire or other casualty shall be received and held by Lessor. In the event the Customer Area is destroyed or damaged by any fire or casualty not covered by the insurance maintained by Lessor or to the extent of not less than 25% of the replacement cost thereof, or if the fire or casualty occurs within the last year of the Term, then Lessor or Customer shall have the option to terminate this Lease by giving notice to the other party within 60 days after the occurrence of such damage or destruction, in which case Lessor shall retain all insurance proceeds with respect to the Customer Area as its own property. If neither Lessor nor Customer elects to terminate this Lease as provided above, this Lease shall continue in full force and effect, but any Lease Fees shall be equitably abated as determined in Lessor's reasonable discretion until the restoration is substantially complete. The provisions of this Agreement shall govern when this Agreement is terminable as a result of a fire or casualty and no other rule or statute on the subject applies. Notwithstanding anything herein to the contrary, in the event a Mortgagee requires that any insurance proceeds be applied to such

indebtedness, then Lessor shall have the right to terminate this Lease by delivering written notice to Customer within 15 days after such requirement is made by any such holder, whereupon the Agreement shall end on the date of such notice as if the date of such notice were the date originally fixed in this Agreement for the expiration of the Term. The provisions of this Section are Customer's sole and exclusive rights and remedies in the event of a casualty. To the extent permitted by applicable laws, Customer hereby waives the provisions of Arizona Revised Statutes § 33-343 and any other applicable existing or future law governing the destruction or injury of a building by the elements or a similar cause permitting an abatement of Lease Fees or termination of a lease agreement in the event of damage or destruction under any circumstances other than as provided in this Section or elsewhere in this Agreement.

**11.2 Condemnation.** If the whole or any material part of the Customer Area or Data Center shall be taken (including, but not limited to a temporary taking for a period of one hundred twenty (120) days or more) by power of eminent domain or condemned by any competent authority for any public or quasi-public use or purpose, if any adjacent property or street shall be so taken or condemned or shall be reconfigured or vacated by such authority in such manner as to require the use, reconstruction or remodeling of any part of the Customer Area or Data Center; or if Lessor shall grant a deed or other instrument in lieu of such taking by eminent domain or condemnation; then Lessor shall have the option to terminate this Agreement upon forty-five (45) days notice, provided such notice is given no later than one hundred eighty (180) days after the date of such taking, condemnation, reconfiguration, vacation, deed or other instrument. Customer shall have a right of termination of this Agreement upon ninety (90) days prior written notice to Lessor in the event that the whole or any material part of the Customer Area is permanently taken. Lessor shall be entitled to receive the entire award or payment in connection therewith, except that Customer shall have the right to file any separate claim available to Customer for any taking of Customer's personal property and fixtures which belong to Customer and are removable by Customer upon expiration of the Term and for moving expenses (so long as such claim does not diminish the award available to Lessor or any Mortgagee and such claim is payable separately to Customer). All Lease Fees shall be apportioned as of the date of such termination or the date of such taking, whichever shall first occur.

Notwithstanding the foregoing, if only the temporary use of the whole or any part of the Customer Area shall be taken by condemnation or eminent domain, the Term shall not be reduced or affected in any way. In such event Customer shall continue to pay the Lease Fees and other charges herein reserved, without reduction or abatement and, except to the extent that Customer is prevented from so doing by reason of any order of the condemning authority, Customer shall continue to perform and observe all of the other covenants, conditions and agreements of this Agreement to be performed or observed by Customer as though such taking had not occurred. In the event of any such temporary condemnation Customer shall also, so long as it is otherwise in compliance with the provisions of this Agreement, be entitled to receive for itself any and all awards or payments made for such use of that portion of the Customer Area so taken; provided, however, that Customer shall repair any and all damage to the Customer Area (whether or not covered by any award to Customer) caused by such temporary condemnation.

## **12. GENERAL PROVISIONS.**

**12.1 Governing Law; Prevailing Party Fees; Waiver of Jury Trial.** This Agreement is to be construed in accordance with and governed by the internal laws of the State of Arizona without giving effect to any choice of law rule that would cause the application of the laws of any other jurisdiction other than the internal laws of the State of Arizona to the rights and duties of the parties. The parties hereby irrevocably consent to the personal and exclusive jurisdiction and venue of the federal and state courts of Maricopa County, Arizona. In any litigation related to this Agreement, the prevailing party shall be entitled to reimbursement of its reasonable attorneys' fees and costs from the other party. **THE PARTIES WAIVE ANY RIGHT TO TRIAL BY JURY, WHETHER SOUNDING IN CONTRACT, TORT OR OTHERWISE, BETWEEN THE PARTIES ARISING OUT OF THIS AGREEMENT OR THE TRANSACTIONS RELATED HERETO.**

**12.2 Force Majeure.** Except for the obligation to pay money, neither party will be liable for any failure or delay in its performance under this Agreement due to any cause beyond its reasonable control, including acts of war or terrorism, acts of God, earthquake, flood, embargo, riot, sabotage, labor shortage or dispute, governmental acts or failure of the Internet, provided that the affected party: (a) gives the other party prompt notice of such cause, and (b) uses its best reasonable efforts to correct promptly such failure or delay in performance.

**12.3 Ownership.** Customer and Lessor hereby mutually acknowledge and agree that Lessor, by this Agreement, grants, conveys and demises to Customer a lease to use and occupy on an exclusive basis (for the purposes set forth herein) the Customer Area only and that this Agreement otherwise does not and shall not be deemed to grant, demise, transfer or otherwise convey to Customer any right, title, or interest whatsoever in or to any portion of the Data Center. Customer hereby acknowledges and agrees that Lessor shall own all items installed by Lessor in the Customer Area, with the exception of the Customer Equipment.

**12.4 Inherently Dangerous Applications.** Customer acknowledges and agrees that the Related Data Center Services are not intended, nor provided by Lessor, for use in connection with, and Customer will not use them for, any nuclear, aviation, mass transit, life-support, telemedicine, or other inherently life-critical applications or services, the failure of which could result in death, personal injury, catastrophic damage or mass destruction.

**12.5 Suspension.** Lessor, in its reasonable discretion, may temporarily suspend, condition or restrict the right of one or more Customer, Colo User, Customer Representative(s) or Customer's invitees to visit the Data Center. Under no circumstances shall Lessor be obligated to provide access to a Customer, Representative or other individual who, in the reasonable judgment of Lessor, represents a threat to the orderly operation of the Data Center or Lessor's provision of Related Data Center Services to Customer or generally.



12.6 Use of Trade Names, etc. Neither party may use the trade name or trademark of the other party hereto without the prior written consent of an authorized representative of the other party in each instance. Notwithstanding the foregoing, Lessor may disclose the name of Customer to any of its employees, vendors, contractors and service providers that have a reasonable need to know such information to assist Lessor in providing the Related Data Center Services and may also include the name of Customer in a list of customer references or other similar marketing materials.

12.7 Government Regulations. Customer will not export, re-export, transfer, or make available, whether directly or indirectly, any regulated item, data or information to anyone outside the U.S. in connection with this Agreement without first complying with Law, including all export control laws and regulations which may be imposed by the U.S. Government and any country or organization of nations within whose jurisdiction Customer operates or does business.

12.8 Legal Process. Lessor reserves the right to comply with any and all warrants, court orders, subpoenas, summons and other legal requirements. With respect to the Customer Area and Customer Equipment, Customer authorizes Lessor to consent to any access, search, seizure or other governmental action which in the reasonable opinion of Lessor is valid. Lessor shall use its best reasonable efforts to notify Customer of any such legal process within forty eight (48) hours of service, but failure to notify Customer shall not restrict Lessor's rights under this Section 12.8 and shall not constitute a material breach hereunder. Lessor reserves the right to restrict or terminate access by Customer or any Representative to the Data Center from and after the service of a search or seizure warrant and/or after receiving an order of a court or government agency. If Lessor in its discretion determines that an emergency exists, Lessor shall be entitled to shut down all or part of the Data Center, including without limitation, the Customer Area, and (if applicable) to comply with an order of any City, County, State or Federal official.

12.9 Integration, Modifications and Severability. This Agreement, together with the Attachments hereto, sets forth the entire agreement of the parties with respect to the subject matter hereof, and supersedes any prior agreements, promises, representations, understandings and negotiations between the parties with respect to said subject matter. Any modifications, amendments, supplements to or waivers of this Agreement must be in writing and executed by authorized representatives of both parties. In the event any provision of this Agreement is held by a tribunal of competent jurisdiction to be invalid, then to the greatest extent possible, the remaining provisions of this Agreement shall remain in full force and effect.

12.10 Waiver. The waiver of any breach or default of this Agreement will not constitute a waiver of any subsequent breach or default, and will not act to amend or negate the rights of the waiving party as specifically stated in this Agreement.

12.11 Assignment.

(a) By Customer. Customer shall not assign its rights or delegate its duties under this Agreement either in whole or in part without the prior written consent of Lessor in Lessor's sole and absolute discretion. The term "assignment" includes the following, whether accomplished directly or indirectly: (a) if Customer is a partnership or limited liability company, the withdrawal or change, voluntarily, involuntarily or by operation of law, of a majority of the partners or members, or a transfer of a majority of ownership interests, in the aggregate on a cumulative basis, or the dissolution of the partnership or limited liability company; and (b) if Customer is a private corporation (i.e., whose stock is not publicly held and traded through an exchange or over the counter), the: (i) dissolution, merger, consolidation or other reorganization of Customer; (ii) sale or other transfer of more than a cumulative aggregate of 50% of the voting shares of Customer (other than to immediate family members by reason of gift or death); or (iii) sale, mortgage, hypothecation or pledge of more than a cumulative aggregate of 50% of Customer's net assets.

(b) By Lessor. Customer acknowledges and agrees that Lessor may assign to one or more Service Providers its rights and obligations with respect to the provision of and/or otherwise contract with one or more Service Providers for the provision of the Related Data Center Services that are to be provided hereunder; provided, however, that Lessor shall provide notice to Customer of any such arrangement with any such Service Provider (and shall provide contact information for each such Service Provider). Customer further acknowledges that Lessor has the right to transfer all or any portion of its interest in the Data Center (including, without limitation, pursuant to a lease or sale of all or any portion of the property of which the Data Center is a part) or in this Agreement, and Customer agrees that in the event of any such transfer to a transferee that agrees to assume the obligations of Lessor hereunder to be performed after the date of such transfer, Lessor shall automatically be released from all liability under this Agreement not accrued as of the date of the transfer and Customer agrees to look solely to such transferee for the performance of Customer's obligations hereunder after the date of transfer and to attorn to such transferee.

(c) General. Any attempted assignment or delegation in violation of this provision shall be null and void. This Agreement will bind and inure to the benefit of each party's successors and permitted assigns.

12.12 Notices; Estoppels.

(a) Notices. Any notice or communication required or permitted to be given hereunder (a) shall be made in writing, (b) may be delivered by hand, mailed by registered or certified mail, return receipt requested, postage prepaid, or sent by recognized overnight courier

maintaining proof of delivery (e.g., FedEx or UPS), (c) shall be sent to the address of the receiving party indicated on the Signature Page, or at such other address as may hereafter be furnished in writing by either party hereto to the other, and (d) shall be deemed to have been given as of the date it is actually delivered, or upon which delivery is refused, whichever is earlier.

(b) Estoppels. At any time and from time to time, within ten (10) days after written notice from Lessor, Customer shall execute, acknowledge and deliver to Customer a statement in writing (which may be relied upon by any prospective purchaser or mortgagee or other like encumbrancer) certifying all matters reasonably requested by Lessor or any current or prospective purchaser, holder of any security document, ground lessor or master lessor. If Customer fails timely to execute and deliver such certificate as provided above, then Lessor and the addressee of such certificate shall be entitled to rely upon the information contained in the certificate submitted to Customer as true, correct and complete, and Customer shall be estopped from later denying, contradicting or taking any position inconsistent with the information contained in such certificate.

12.13 Subordination; Attornment. This Lease is and will be subject and subordinate at all times to any and all Security Documents which may now exist or hereafter be executed which constitute a lien upon or affect the Data Center or any portion thereof, or Lessor's interest and estate in any of said items. Notwithstanding the foregoing, Lessor reserves the right to subordinate any such Security Documents to this Lease. In the event of any termination or transfer of Lessor's estate or interest in the Data Center or the Customer Area by reason of any termination or foreclosure of any such Security Documents (and notwithstanding any subordination of such Security Document to this Lease that may or may not have occurred), at the election of Lessor's successor in interest, Customer agrees to attorn to and become the lessee of such successor. Customer covenants and agrees to execute and deliver, within ten (10) days of notice thereof, any additional documents evidencing the priority or subordination of this Lease and Customer's agreement to attorn with respect to any such Security Document.

12.14 Counterparts. This Agreement may be executed in two or more counterparts, each of which will be deemed an original, but all of which together shall constitute one and the same instrument.

12.15 Relationship of Parties. Nothing contained in this Agreement shall be deemed to establish any relationship of partnership, joint venture, employment, franchise or other agency or relationship between Lessor and Customer other than that of lessor and lessee. Neither Lessor nor Customer have the power to bind the other or incur obligations on the other's behalf without the other's prior written consent, except as otherwise expressly provided herein.

12.16 No Negative Construction. Each party acknowledges and agrees that it has reviewed, and has had an opportunity to have reviewed by legal counsel, this Agreement (including all Attachments hereto), and it is the parties' intent that this Agreement not be construed against either party as the drafting party.

12.17 Priority. The following order of precedence will govern any conflict or discrepancy between any portions of this Agreement:

1. Attachment A – Pricing Form
2. Attachment B – Terms and Conditions
3. Attachment C – Rules and Regulations
4. Attachment D – Service Level Agreement
5. Signature Page

<< End of Attachment B – Terms and Conditions >>

**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 .
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: May 15, 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.
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 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: May 15, 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 March 31, 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, as amended; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Newtek as of and for the periods covered in the Report.

/s/ Barry Sloane  
Barry Sloane, Chief Executive Officer

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

Dated: May 15, 2007

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