NEWTEK BUSINESS SERVICES INC
Form S-3/A
April 23, 2004

As filed with the Securities and Exchange Commission on April 23, 2004

Registration No. 333-81610

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM S-3

REGISTRATION STATEMENT

Under

THE SECURITIES ACT OF 1933

Amendment No. 8

NEWTEK BUSINESS SERVICES, INC.

(Exact name of registrant as specified in its charter)

NEW YORK	**11-3504638**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

100 QUENTIN ROOSEVELT BLVD., SUITE 408

GARDEN CITY, NEW YORK 11530

(516) 390-2260

(Address, including zip code, and telephone number, including area code, of Registrant s principal executive offices)

BARRY SLOANE

CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER

NEWTEK BUSINESS SERVICES, INC.

462 SEVENTH AVENUE, 14TH FLOOR

NEW YORK, NEW YORK 10018

(212) 356-9500

(Name, address, including zip code, and telephone number, including area code, of agent for service of process)

Copies To:

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APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE OF SECURITIES TO THE PUBLIC: As soon as practicable after the effective date of this Registration Statement.

If the only securities being registered on this form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. ¨

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. x

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If the delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ¨

The registrant hereby amends this registration statement on such date or dates as maybe necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall there after become effective in accordance with section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said section 8(a), may determine.

1,661,631 SHARES

NEWTEK BUSINESS SERVICES, INC.

COMMON STOCK

This prospectus relates to the offering of 1,661,631 shares of our common stock, par value $0.02 per share. These shares may be sold from time to time by our current stockholders, who acquired these shares from us through private transactions.

The selling stockholders may sell the shares at prices determined by the prevailing market price for the shares or in negotiated transactions. We will not receive any proceeds from the sale of these shares.

Our common stock is traded on The Nasdaq Stock Market under the symbol NKBS . On April____ , 2004, the last reported sale price of our common stock was $______ per share.

BEFORE BUYING ANY SHARES YOU SHOULD READ THE DISCUSSION OF MATERIAL RISKS OF INVESTING IN OUR COMMON STOCK IN RISK FACTORS BEGINNING ON PAGE 4.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES, OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this prospectus is April ______, 2004.

TABLE OF CONTENTS

PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in this prospectus. It is not complete and does not contain all of the information that you should consider before investing in the shares. You should read the entire prospectus carefully, including the Risk Factors section, our consolidated financial statements and the related notes, as well as the information that we incorporate by reference in this prospectus.

The Company

Newtek Business Services, Inc. is a holding company for several wholly- and majority-owned operating subsidiaries, which provide a variety of complementary financial products and business services to small and medium-sized businesses. We currently operate in three principal lines of business and we expect to begin operating in three additional complementary lines of business later in 2004. Our three existing principal lines of business are as follows:

Certified capital companies*:* A certified capital company, or capco, is a company we create pursuant to a state sponsored program which is designed to encourage investment in small and new businesses in the state and to create economic activity and jobs in a designated geographic area. Historically, we have financed our operations and derived most of our revenue and income from state-sponsored capco programs and other related investments and operations. We have used capco funds to finance or acquire three of our other five operating businesses. To date, the primary source of cash for Newtek itself has been the statutorily fixed, annual management fees of 2.5% of each capco s initial capital.

SBA loans. Through one of our operating subsidiaries, Newtek Small Business Finance, Inc., or NSBF, we make small business loans guaranteed by the U.S. Small Business Administration, or SBA. Our business clients use the loan proceeds to acquire commercial real estate, machinery, equipment and inventory, to refinance debt, to fund franchises, to acquire businesses and for working capital. NSBF is one of 14 companies licensed to provide SBA loans nationwide under the federal section 7(a) loan program for small businesses and the related section 504 business real estate loan program. John Cox, who spent 30 years at the SBA and was previously Associate Administrator for Financial Assistance, the senior official in charge of SBA lending, is Chairman and CEO of NBSF.

Payment processing solutions. Our Newtek Merchant Solutions subsidiaries offer credit card, debit card and gift card processing services and check approval services to approximately 5,000 small and medium-sized businesses through four payment processing companies and a full service processing center in Wisconsin.

Our three new or reorganized complementary lines of business that we expect to be fully operational during 2004 are as follows:

Small business financial and management reporting and planning systems conducted by *Newtek Financial Information Services*.

Small business tax services conducted by Newtek Tax Services, LLC.

Small business insurance, including property, casualty and life insurance to be provided through *Newtek Insurance Agency, LLC*.

Financial Highlights

We have experienced significant growth since 2000, as evidenced by the following.

Our total revenue was $8.7 million in 2000, compared to $60.5 million in 2003, an increase of approximately 595%.

We incurred a loss of $3.4 million in 2000, compared to net income of $9.6 million in 2003.

1

During 2002, the capcos generated non-cash revenues related to the tax credits issued to the capco investors of approximately $30.6 million, or 88% of total revenue. During 2003, the capcos generated non-cash revenues related to the capco tax credits of approximately $44.9 million, or 74% of total revenue.

During 2002, Newtek Small Business Finance and Newtek Merchant Solutions generated aggregate revenues of approximately $1.6 million, or 4.6% of total revenue. During 2003, these business lines generated aggregate revenues of approximately $13.7 million, or 23% of total revenue.

Business Strategy

Key elements of our strategy to grow our business are:

Aggressively refocus business model to serve the small and medium-sized business market. Over the last three years, we have refined our business model to focus primarily on developing and marketing products and services aimed at small and medium-sized businesses like those which we initially funded through our participation in capco programs. As our service offering grows and diversifies, we intend to continue to reduce our dependence on the capco programs as both a source of funding and correspondingly a source of revenue.

Further develop national recognition of the Newtek brand through marketing alliances. We have formed key marketing alliances with national business organizations such as Merrill Lynch and Cendant Corporation, business and trade organizations such as the Credit Union National Association and the Community Bankers of Wisconsin and affinity organizations such as Revelation Corporation of America, Navy Federal Credit Union and the semi-public Veterans Corporation of America. These strategic partners, through their customers, members and participants, generate small business lending and payment processing business for us and build awareness of our brand name.

Cross-sell additional products and services to small- and medium-sized businesses. Our web based, proprietary Referral System is a custom designed customer relations management tool which allows us to utilize our alliance partners client bases efficiently and cost effectively to cross-sell our products and services to our alliance partners customers, members and participants.

Utilize our proprietary, customer-friendly technology to process business applications and financial transactions. Our applications processing technology allows us to process new business utilizing a web based system and a centralized processing point. Our trained representatives use these web-based applications as a tool to acquire and process data, eliminating the need for face to face contact and the requirement that a customer complete multiple paper forms. This approach is customer friendly, allows us to process applications very efficiently and allows us to store client information for further processing and future cross-selling efforts.

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

Continue to access the capco market as capco opportunities arise. We believe there is continued opportunity to use the capco programs as a funding source to facilitate the growth of our businesses.

Resale Registration

We are registering these securities for resale by the selling stockholders and will receive no proceeds from their disposition. A substantial portion of the registered securities are subject to contractual restrictions on transfer for up to three years. See Selling Stockholders.

About Us

We were incorporated in 1999 in New York and changed our name from Newtek Capital, Inc. to Newtek Business Services, Inc. in November 2002. Our principal executive offices are located at 100 Quentin Roosevelt Blvd., Garden City, New York 11530 and our telephone number is (516) 794-0100. Our website address is www.NewtekBusinessServices.com. Information incorporated into our website is not a part of this prospectus.

The following chart describes the role of capcos in our business and the major sources of our revenue and income:

NEWTEK REVENUE GENERATION

(1) We have invested $3.9 million in seed capital for 11 capcos through January 2004.

(2) Our capcos (in conjunction with our capco insurer) have raised approximately $185 million from insurance company investors through January 2004.

(3) $74.3 million invested in businesses through December 31, 2003.

(4) $53.2 million actually invested in such companies through December 31, 2003.

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

(6) Our non-capco revenue increased by over four times from 2002 to 2003 and increased from 8% to 24% of total revenue.

R ISK FACTORS

Before you invest in our common stock, you should carefully consider the following risks as well as the other information in this prospectus in evaluating the investment.

RISKS RELATING TO OUR BUSINESS GENERALLY

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

We have placed primary emphasis on the investment in and acquisition of small businesses with the objective of developing a network of successful and profitable businesses, most of which will principally serve the small business market. Such early stage businesses have an historically higher rate of failure than larger businesses and many, if not failing, will have only limited profitability. Moreover, profit generated by any of our operating companies or other investments could be offset by losses generated by others. Our profitability resulting from the operations of its businesses may be delayed for the foreseeable future.

For example, our consolidated subsidiaries experienced aggregate net losses of approximately $2.7 million for the year ended December 31, 2003 and a net loss of approximately $3.6 million for the year ended December 31, 2002. We recorded no net losses from equity method investees in 2003 and approximately $729,000 in the year ended December 31, 2002. In addition, during 2003 we wrote off approximately $2 million of investments in small businesses, compared to approximately $1.6 million in 2002, representing management s best estimate as to the amount of the other than temporary decline in the value of the investments.

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

In the past few years we have increasingly concentrated our investments in companies participating in small business lending and electronic payment processing, a commitment to our financial information systems business, and we plan to make significant investments in our national insurance agency and small business tax services businesses in the near future. Each of these businesses has numerous risks associated with them.

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

We presently rely primarily on the capco (certified capital company) programs for funding our investments and our capcos are limited by regulations in the types of investments they can make.

Our ability to invest in or acquire companies has in the past and is expected to be in the future limited to investments permissible to the capco programs in which we participate. In the programs under which the capcos operate, investments by a capco may only be made in the state in which the particular capco operates and the target company must meet certain requirements as to size, employment of state residents and possible restrictions on the ability to relocate. These limitations may require us to forego attractive or desirable investments, which could adversely affect or prevent implementation of our business strategy.

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

In recent years, we have experienced rapid growth that has placed, and will continue to place, certain pressures on our management, administrative, operational and financial infrastructure. As we continue to grow our business, such growth could require capital, systems development and human resources beyond what we currently have. As evidence of our internal growth, on December 31, 2001, we and all of our consolidated and majority-owned affiliates had approximately 20 employees, and on December 31, 2003 we had 115 employees, without consideration of independent contractors. The increase in the size of our operations may make it more difficult for us to ensure that we execute our present businesses and future strategies. The failure to manage our growth effectively could have a material adverse effect on our financial condition and our results of operations.

Because expenses are expected to increase as we build an infrastructure and implement our business strategy, we may incur additional losses in the future.

Because our expenses are expected to increase as we build an infrastructure and implement our business strategy, we will likely incur significant additional losses in the near future. We expect the additional expenses to result primarily from our plans to:

- expand existing systems;
- broaden affiliated company support capabilities;
- continue to explore acquisition opportunities and alliances; and
- facilitate business arrangements among affiliated companies.

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

If we and our affiliated companies are unable to obtain the resources the affiliated companies require for their growth and development, the affiliated companies will be highly susceptible to failure, which would directly affect our profitability and value. Early-stage businesses often fail due to their limited material and human resources. The success of our business model is dependent upon the ability of the affiliated companies, with assistance from us, to arrange for the managerial, capital and other resources which they usually require in order to become and remain profitable.

We may require additional capital beyond the capco programs, which may not be available on satisfactory terms or at all.

To the extent permissible under applicable state laws, we intend to utilize the capco programs to fund the growth and operations of our investments. If these funds are not available or are available but not sufficient, we or our affiliated companies will have to access the private or public capital markets. If access to these markets is not available or is available but on unacceptable terms, we may lack the funds necessary to expand our operations, become profitable or execute our business strategy. The inability to raise funds in the capital markets may result in a material loss to us and our shareholders.

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

We have made three strategic acquisitions and we intend to continue to make acquisitions in furtherance of our business plan. Each acquisition does and will in the future involve a number of risks. These risks include:

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

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

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

Although we believe that we are currently in compliance in all material respects with applicable federal, state and local laws, rules and regulations, we cannot assure you that we or our affiliated companies are, or that we will continue to be, in full compliance with current laws, rules and regulations. If we or are affiliated companies are unable to comply with applicable laws or regulations or if new laws limit or eliminate some of the benefits of our business lines, our financial condition and our results of operations will be materially adversely affected.

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

Our success now and in the future depends to a significant extent on the continued services of our senior management, particularly Messrs. Sloane, Wasserman and Rubin, respectively, our CEO, CFO and President. The loss of the services of these individuals could have a material adverse effect on our financial condition and results of operations. This is true notwithstanding the maintenance of key man life insurance on each of these executives.

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

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

Our success is dependent on our ability to compete effectively in the highly competitive businesses in which we operate.

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

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

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

We rely on information processing systems, and our growing strategy of cross marketing to customers among our operating subsidiaries will increase this reliance.

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

Risks Related to our Capco Business

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

Involuntary decertification of all or substantially all of our capcos would result in material loss to us and our shareholders. In general, capcos issue debt and equity instruments, such as warrants, to insurance company investors and the capcos then acquire interests in companies in accordance with applicable state statutes. In return, the states issue tax credits to the capcos, which are available to and used by the insurance company investors to reduce their state tax liabilities. In order to maintain its status as a capco and to avoid the recapture of the tax credits granted, each capco must meet a number of state requirements. A key requirement in order to continue capco certification is that a capco must comply with minimum investment schedules that benchmark both the timing and type of required investments. A final involuntary loss of capco status, that is, decertification as a capco, will result in loss of the tax credits for us and our insurance company investors; it would also enable the capco insurer, which has the obligation to make compensatory payments to offset the lost tax credits, to take control of one or more capcos and manage or liquidate the capco investments to offset its losses. This would deprive us of the value of the investments and make participation in future capco programs highly unlikely. See Certified Capital Companies capcos Newtek s Record of Compliance for details on the manner in which our capcos have met all applicable investment schedules in advance of the statutory deadlines.

The ability of our capcos to meet minimum investment requirements is materially and adversely effected by the cost of the capco insurance.

Each of our capcos, following their organization and payment for capco insurance, begin operations with cash approximately equal to 50% of certified capital, the amount on which the minimum investment requirement is based. In order to avoid decertification, and remain in compliance with applicable rules, each capco must invest an amount at least equal to 50% of certified capital in qualified investments. The capcos receive full credit in the minimum investment calculation for the reinvestment of funds returned to the capco by the repayment, sale or liquidation of investments. However, each capco s ability to meet its minimum requirement could be adversely effected by:

- the cost of insurance at the out set of each capco s investment cycle;
- the transfer of 2.5% of certified capital per year as management fees to us
- the direct costs and expenses of operating the capco including legal and accounting fees;
- the payment of taxes due by the capco; and
- losses by the capcos, typical on investments in riskier early-stage, start up and potentially high growth businesses.

As of December 31, 2003 seven of our ten operating capcos have met the minimum investment requirements (an eleventh was formed and funded in January 2004 and Exponential is not included as we only manage but do not own it). However, the remaining three capcos must invest $9.1 million in the aggregate. Failure of one of these four capcos to make the minimum investments within the prescribed time frames would lead to decertification of a capco.

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

The tax credits associated with the capco programs and provided to our capcos investors are to be utilized by the investors over up to ten years. Much can change during such a period and it is possible that one or more states may attempt to revise or eliminate the tax credits for one reason or another. If such a repeal is successful, the repeal could have a material adverse economic impact on our capco, either directly or as a result of the capco s insurer s actions. During 2002 a single legislator in Louisiana did introduce such a proposed bill, on which no action was taken, and in Colorado in 2003 a bill to modify (not repeal) its capco program was introduced but defeated in a legislative committee. The Colorado bill could have had an adverse material impact if adopted in its proposed form.

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

Under the terms of insurance policies purchased by all but one of the capcos for the benefit of the investors, the capco insurer is authorized, in the event of a formal written threat of decertification by a state, and absent appropriate corrective action by the capco, to assume up to complete control of a capco so as to avoid final decertification and the requirement to pay compensatory interest payments to the certified investors under the policies. While avoiding final decertification, control by the insurer would result in significant disruption of the capco s business and likely result in financial loss to the capco and Newtek.

In the absence of the adoption of new capco programs, we will be unable to derive any new income from tax credits, which to date represents substantially all of our income.

Virtually all of our net income for each of the years since inception in 1998 was derived from the recognition of income related to tax credits available under current certified capital company programs. We will recognize additional income related to tax credits from the current capco programs over the next ten years. Thereafter, unless additional capco programs are adopted and we are able to participate in them, we will derive no income from additional capco programs. The adoption of new state capco programs could be materially and adversely affected by the continuation of adverse economic conditions or a change in the political acceptability of economic development or capco programs.

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

In all capco programs we recognize the majority of our income from the tax credits in the early years of the programs because income recognition is tied to the schedule by which the tax credits become irrevocable and beyond recapture (approximately five years). We recognize the majority of our income from ten year capco programs in the first five years. In the absence of income from other sources, such as our investments in small businesses and affiliated companies, we would likely sustain material losses in later years. Although we will not be recognizing significant tax credit income in the latter part of the program, we will continue to incur costs for the administration of the capcos, insurance expenses of the capcos and interest expenses of the capco notes. Currently seven of our capcos have been in operation for three or four years, four have been formed in the last two years, and one was formed in January, 2004 and another one is expected to begin operations later in 2004. In the absence of our participation in new capco programs, income from tax credits will remain stagnant or decrease as the capcos reach maturity beginning in 2004.

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

In the absence of any meaningful peer group comparisons for our capco business, individual investors as well as institutional investors may have a harder time understanding and judging the strength of our business and this, in turn, may have a depressing effect on the value of our stock.

If we are deemed to be an investment company under the Investment Company Act of 1940, we will not be able to execute successfully our business strategy.

Because capcos can operate in a manner similar to venture capital funds, there is a risk that the Securities and Exchange Commission or a court might conclude that we fall within the definition of investment company, and unless an exclusion were available, we would be required to register under the Investment Company Act of 1940. Compliance with the Investment Company Act, as a registered investment company, would cause us to alter significantly our business strategy of participating in the management and development of affiliated companies, impair our ability to operate as planned and seriously harm our business. If we fail to comply with the requirements of this Act, we would be prohibited from engaging in business or selling securities, and could be subject to civil and criminal actions for doing so. In addition, our contracts would be voidable and a court could appoint a receiver to take control of and liquidate our business.

The SEC has adopted Rule 3a-1 that provides an exclusion from registration as an investment company if a company meets both an asset and an income test and is not otherwise primarily engaged in an investment company business by, among other things, holding itself out to the public as such or by taking controlling interests in companies with a view to realizing profits through subsequent sales of these interests. A company satisfies the asset test of Rule 3a-1 if it has no more than 45% of the value of its total assets (adjusted to exclude U.S. Government securities and cash) in the form of securities other than interests in majority-owned subsidiaries and companies which it primarily and actively controls. A company satisfies the income test of Rule 3a-1 if it has derived no more than 45% of its net income for its last four fiscal quarters combined from securities other than interests in majority owned subsidiaries and primarily and actively controlled companies.

Risks Relating to the Ownership of Our Common Stock

Three of our shareholders, all of whom are executive officers and directors, currently hold approximately 46% of our common stock and can effectively control the outcome of most shareholder actions.

Because of their ownership of stock, three of our shareholders, Messrs. Sloane, Wasserman and Rubin, may effectively be able to control or have significant influence over the actions requiring shareholder approval, including:

- the election of directors;
- the appointment of management; and
- the approval of actions that usually requires shareholder authorization, including the adoption of amendments to the articles of incorporation, approval of stock incentive plans, and approval of major transactions such as a merger of sale of assets.

There is a limited trading market for our common stock and you may not be able to resell your shares at or above the price you pay for them.

The price of our common stock has been, and will likely continue to be, subject to fluctuations based on, among other things, economic and market conditions for companies in similar industries to ours and the stock market in general, as well as changes in investor perceptions of us. The development and maintenance of an active public trading market depends, however, upon the existence of willing buyers and sellers, the presence of which is beyond our control. While we are a publicly-traded company, the volume of trading activity in our stock is relatively small.

The current public float of our common stock is approximately 14.7 million shares and the average daily trading volume of our common stock from December 31, 2002 through December 31, 2003 was approximately 50,000 shares. Even if a more active market develops, there can be no assurance that such a market will continue, or that our shareholders will be able to sell their shares at or above the offering price.

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

Our Board of Directors has the authority, without action or vote of our shareholders, to issue all or part of the 13 million authorized but unissued shares of our common stock and 1 million shares of preferred stock. If issued, these common shares would represent approximately 33% of our total shares of common stock outstanding. We anticipate granting additional options or restricted stock awards to our employees and directors pursuant to the terms of our incentive stock option plans in the future. We may also issue additional securities, through public or private offerings, in order to raise additional capital to support our growth or in connection with possible acquisitions or in connection with purchasing minority interests in affiliated companies or capcos. Future issuances of our common stock will dilute the percentage of ownership interest of our shareholders and may dilute the per share book value of our common stock. In addition, option holders may exercise their options at a time when we would otherwise be able to obtain additional equity capital on more favorable terms.

Pursuant to our Articles of Incorporation, our Board of Directors is authorized to issue up to 1,000,000 shares of blank check preferred stock, meaning that our Board of Directors may, in their discretion, cause the issuance of one or more series of preferred stock and fix the designations, preferences, powers and relative participating, optional and other rights, qualifications, limitations and restrictions thereof, including the dividend rate, conversion rights, voting rights, redemption rights and liquidation preference, and to fix the number of shares to be included in any such series. The preferred stock so issued may rank superior to the common stock with respect to the payment of dividends or amounts upon liquidation, dissolution or winding-up, or both. In addition, the shares of preferred stock may have class or series voting rights.

Our business strategy relies upon investment in and acquisition of businesses, using the resources available to us including our common stock. The issuance of substantial amounts of our common stock to support acquisitions could have a dilutive effect on our shareholders.

We have made three acquisitions during 2002 and 2003 and all involved the issuance of our common stock. We expect to make additional acquisitions in the future using our common stock which would dilute the ownership of current shareholders and could decrease book value or earnings per share.

Substantial sales of shares may impact the market price of our common stock.

If our shareholders sell substantial amounts of our common stock, the market price of our common stock may decline. These sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate. We are unable to predict the effect that sales may have on the then prevailing market price of our common stock. Also, this risk is compounded by the fact that three of our executive officers and directors own approximately 46% of our common stock and sales by any one of them of substantial numbers of shares could adversely affect the market price.

Provisions of our Articles of Incorporation and New York law place restrictions your ability to recover from our directors.

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

Risks Relating to Our SBA Lending Business

We have specific risks associated with small business administration loans.

We have generally sold the guaranteed portion of Small Business Administration loans, or SBA loans, in the secondary market. There can be no assurance that we will be able to continue originating these loans, or that a secondary market will exist for, or that we will continue to realize premiums upon the sale of, the guaranteed portions of the SBA loans. The federal government presently guarantees in various programs 50% to 85% of the principal amount of each qualifying SBA loan. There can be no assurance that the federal government will maintain the SBA program, or if it does, that such guaranteed portion will remain at its current funding level.

We believe that our SBA loan portfolio does not involve more than a normal risk of collection. However, since we have sold the guaranteed portion of substantially all of our SBA loan portfolio, we incur a pro rata credit risk on the nonguaranteed portion of the SBA loans since we share pro rata with the SBA in any recoveries. In the event of default on an SBA loan, our pursuit of remedies against a borrower is subject to SBA approval, and where the SBA establishes that its loss is attributable to deficiencies in the manner in which the loan application has been prepared and submitted, the SBA may decline to honor its guarantee with respect to the combined company s SBA loans or it may seek the recovery of damages from the combined company. The SBA has never declined to honor its guarantees with respect to our SBA loans made since our acquisition of the lender, although no assurance can be given that the SBA would not attempt to do so in the future.

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

If we cannot continue making and selling government guaranteed loans, we will have less origination fees and less ability to generate gains on sale of loans. From time to time, the government agencies that guarantee these loans reach their internal budgeted limits, and cease to guarantee loans for a stated time period. In addition, these agencies may change their rules for loans. Also, Congress may adopt legislation that would have the effect of discontinuing or changing the programs. Nongovernmental programs could replace government programs for some borrowers, but the terms might not be equally acceptable. If these changes occur, the volume of loans to small business and industrial borrowers of the types that now qualify for government guaranteed loans could decline, as could the profitability of these loans.

Changing interest rates may reduce our income from lending.

Fluctuations in interest rates may affect the demand of customers for our loans and other products and services. Our loans and the funds used to make the loans which we borrow are tied to the same interest rate index, so we do not have any significant exposure to yield spread risk. However, our lending business could be expected to increase during times of falling interest rates and, conversely, to decrease during times of significantly higher interest rates. Significant fluctuations in interest rates will have an effect on our results of operations which may be adverse.

Our ability to participate in the SBA government-guaranteed loan program is dependent on our ability to obtain sufficient warehouse or similar lending facilities, on sufficiently attractive terms, to enable us to make loans on a profitable basis.

In conjunction with the acquisition of our SBA lending affiliate, we were able to assist in the renegotiation and extension of a major warehouse loan facility from an affiliate of Deutsche Bank. This warehouse line enables our SBA lender to fund loans and repay the line at the time all or a portion of the loan is sold, as is typically the case. In the absence of this warehouse line of credit the SBA lender would be unable to make any material number of loans without finding a replacement lending facility. Furthermore, our interest spread and net earnings from this segment of our business would be directly affected by the terms and conditions of the replacement lending facilities.

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

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

12

Risks Relating to Our Electronic Payment Processing Business

We rely on bank sponsors, which have substantial discretion with respect to certain elements of our business practices, in order to process bankcard transactions. If these sponsorships are terminated and we are not able to secure or successfully migrate merchant portfolios to new bank sponsors, we will not be able to conduct our electronic payment processing business.

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

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

Substantially all of the transactions we process involve Visa or MasterCard. If we or our bank sponsors fail to comply with the applicable requirements of the Visa and MasterCard credit card associations, Visa or MasterCard could suspend or terminate our registration. The termination of our registration or any changes in the Visa or MasterCard rules that would impair our registration could require us to stop providing payment processing services.

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

Our electronic payment processing business relies on agreements with several other large payment processing organizations to enable us to provide card authorization, data capture, settlement and merchant accounting services and access to various reporting tools for the merchants we serve. We also rely on third parties to whom we outsource specific services, such as reorganizing and accumulating daily transaction data on a merchant-by-merchant and card issuer-by-card issuer basis and forwarding the accumulated data to the relevant bankcard associations. Many of these organizations and service providers are our competitors and we do not have long-term contracts with most of them. Typically, our contracts with these third parties are for one-year terms and are subject to cancellation upon limited notice by either party.

The termination by our service providers of their arrangements with us or their failure to perform their services efficiently and effectively may adversely affect our relationships with the merchants whose accounts we serve and may cause those merchants to terminate their processing agreements with us.

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

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

Unauthorized disclosure of merchant or cardholder data, whether through breach of our computer systems or otherwise, could expose us to protracted and costly litigation.

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

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

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

We face potential liability for merchant or customer fraud.

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

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

Risks Relating to Our Insurance Agency Business

Competition is intense in the insurance market.

The insurance agency and brokerage business is highly competitive. There are many insurance agency and brokerage organizations with which we will actively compete. Many of the competing firms are significantly larger than us and have many times the revenues that we have. We are also in competition with insurance companies that write insurance directly for their customers and do not pay commissions to agents.

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

We are dependent on third parties, particularly property and casualty insurance companies, to supply the products marketed by our insurance agency. Once we complete our contracts with these suppliers, they will typically provide that the contracts can be terminated by the supplier without cause with written notice. Our inability to enter into satisfactory arrangements with these suppliers or the loss of these relationships, for any reason, would adversely affect our financial operations.

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

Without professional liability insurance, it is unlikely that we would continue in any relationships with insurance companies. We are currently in the process of obtaining necessary professional liability insurance to cover the operations of the insurance agency and meet applicable state licensing requirements. Once obtained, our failure to maintain this insurance would have a material adverse impact on the business.

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

Our insurance agency activities will be subject to comprehensive regulation in the various states in which we do business. Our success will depend in part upon our ability to satisfy these regulations and to obtain and maintain all required licenses and permits. Although we believe that we are currently in material compliance with statutes and regulations applicable to our business, we cannot assure you that we will be able to maintain compliance without incurring significant expense. Our failure to comply with any current or subsequently enacted statutes and regulations could have a material adverse effect on us. Furthermore, the adoption of additional statutes and regulations, changes in the interpretation and enforcement of current statutes and regulations, or the expansion of our business into jurisdictions that have adopted more stringent regulatory requirements than those in which we currently conduct business could have a material adverse effect on us.

The commission revenue our insurance agency expects to earn on the sale of insurance products is based on premiums and commission rates set by insurers and the conditions prevalent in the insurance market, neither of which we have any control over.

Our insurance agency expects to derive revenue from commissions on the sale of insurance products that are paid by the insurance underwriters from whom our clients purchase insurance. Commission rates and premiums can change based on the prevailing economic and competitive factors that affect insurance underwriters. In addition, the insurance business historically has been cyclical, characterized by periods of intense price competition due to excessive underwriting capacity as well as periods when shortages of capacity permitted favorable premium levels and changes in terms and conditions. We cannot predict the timing or extent of future changes in commission rates or premiums. As a result, we cannot predict the effect that any of these changes will have on the operations of our insurance agency. These changes may result in revenue decreases for us.

WHERE YOU CAN FIND MORE INFORMATION;

INCORPORATION BY REFERENCE

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. Our file number under the Securities Exchange Act is 1-16123. You may read and copy, upon payment of a fee set by the SEC, any document that we file with the SEC at its public reference rooms in Washington, D.C. (450 Fifth Street, N.W., 20549) and Chicago, Illinois (Citicorp Center, 500 West Madison Street, 14th Floor, Suite 1400, 60661). You may also call the SEC at 1-800-432-0330 for more information on the public reference rooms. Our filings are also available to the public on the Internet, through the SEC s EDGAR database. You may access the EDGAR database at the SEC s web site at http://www.sec.gov.

The SEC allows us to incorporate by reference into this prospectus the information we file with them. This means that we can disclose important business, financial and other information in our SEC filings by referring you to the documents containing this information. All information incorporated by reference is part of this prospectus, unless that information is updated and superseded by the information contained in this prospectus or by any information filed subsequently that is incorporated by reference or by any prospectus supplement. Any prospectus supplement or any information that we subsequently file with the SEC that is incorporated by reference will automatically supersede any prior information that is part of this prospectus or any prior prospectus supplement. We incorporate by reference the documents listed below and any future filings made with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 until the termination of this offering:

Proxy Statement filed April 30, 2003.

The description of our Common Stock contained in our Registration Statement on Form 8-A, filed September 18, 2000, which registered our common stock under Section 12(b) of the Securities Exchange Act of 1934.

Annual Report on Form 10-K for the year ended December 31, 2003, filed March 30, 2004.

Current Report on Form 8-K dated February 26, 2004 relating to separate marketing agreements with Merrill Lynch Business Financial Services, Inc. and CBW Financial Services, Inc.

Current Report on Form 8-K dated March 2, 2004 relating to a press release announcing the Company s preliminary results for its fourth fiscal quarter and fiscal year ending December 31, 2003 and announced a marketing agreement with The Navy Federal Credit Union.

This prospectus is part of a Registration Statement on Form S-3 we have filed with the SEC relating to our common stock registered under the Securities Act of 1933. As permitted by SEC rules, this prospectus does not contain all of the information contained in the Registration Statement and accompanying exhibits and schedules we file with the SEC. You may refer to the registration statement, the exhibits and schedules for more information about us and our common stock. The registration statement, exhibits and schedules are also available at the SEC s public reference rooms or through its EDGAR database on the internet.

You may obtain a copy of these filings at no cost by writing to us at Newtek Business Services, Inc., 100 Quentin Roosevelt Boulevard, Suite 408, Garden City, New York, Attention: Ellen Merryman, or by telephoning us at (516) 794-0100. In order to obtain timely delivery, you must request the information no later than five business days prior to the date you decide to invest in our common stock.

You should rely only on the information incorporated by reference or provided in this prospectus or any prospectus supplement. We have not authorized anyone to provide you with different information. We are not making an offer of these securities in any state where the offer is not permitted. You should not assume that the information in this prospectus or any prospectus supplement is accurate as of any date other than the date on the front of this prospectus.

SPECIAL NOTE OF CAUTION REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained in (i) this prospectus, (ii) any applicable prospectus supplement and (iii) the documents incorporated by reference into this prospectus, may constitute forward-looking statements within the meaning of the federal securities laws. Forward-looking statements are based on our management s beliefs, assumptions and expectations of our future economic performance, taking into account the information currently available to them. These statements are not statements of historical fact. Forward-looking statements involve risks and uncertainties that may cause our actual results, performance or financial condition to be materially different from the expectations of future results, performance or financial condition we express or imply in any forward-looking statements. Some of the important factors that could cause our actual results, performance or financial condition to differ materially from our expectations are:

The performance of our consolidated operating companies, aspects of which are outside our control.

Losses by the capcos due to investments in riskier early-stage and start up businesses could make it significantly more difficult for the capcos to meet minimum state statutory investment benchmarks and thus subject the capcos to decertification and further financial loss.

The degree and nature of our competition and that of our consolidated operating companies.

The lack of widespread acceptance of the commercial use of the Internet, which may be material to one or more of our consolidated operating companies.

Our ability, and that of our consolidated operating companies, to attract and retain key managerial and technical personnel.

Changes in government regulation of our business and those of our consolidated operating companies.

When used in our documents or oral presentations, the words anticipate , estimate , expect , objective , projection , forecast , goal , or simil are intended to identify forward-looking statements. We qualify any such forward-looking statements entirely by these cautionary factors.

PLAN OF DISTRIBUTION

We are registering all 1,661,631 shares on behalf of the selling stockholders. The selling stockholders named in the table below or pledgees, donees, transferees or other successors-in-interest selling shares received from the named selling stockholders as a gift or other non-sale-related transfer after the date of this prospectus may sell the shares from time to time. The selling stockholders may also decide not to sell all the shares they are allowed to sell under this prospectus. The selling stockholders will act independently of us in making decisions with respect to the timing, manner and size of each sale. The sales may be made on one or more exchanges or in the over-the-counter market or otherwise, at prices and at terms then prevailing or at prices related to the then current market price, or in negotiated transactions. The selling stockholders may effect such transactions by selling the shares to or through broker-dealers. Our common stock may be sold by the selling stockholders in one or more of, or a combination of, the following transactions:

a block trade in which the broker-dealer so engaged will attempt to sell our common stock as agent but may position and resell a portion of the block as principal to facilitate the transaction,

purchases by a broker-dealer as principal and resale by such broker-dealer for its account pursuant to this prospectus,

an exchange distribution in accordance with the rules of such exchange,

ordinary brokerage transactions and transactions in which the broker solicits purchasers, and

in privately negotiated transactions.

To the extent required, this prospectus may be amended or supplemented from time to time to describe a specific plan of distribution. In effecting sales, broker-dealers engaged by the selling stockholders may arrange for other broker-dealers to participate in the resales.

The selling stockholders may enter into hedging transactions with broker-dealers in connection with distributions of our common stock or otherwise. In such transactions, broker-dealers may engage in short sales of the shares in the course of hedging the positions they assume with the selling stockholders. The selling stockholders also may sell shares short and redeliver our common stock to close out such short positions. The selling stockholders may enter into option or other transactions with broker-dealers which require the delivery to the broker-dealer of our common stock. The broker-dealer may then resell or otherwise transfer such shares pursuant to this prospectus. The selling stockholders also may loan or pledge the shares to a broker-dealer. The broker-dealer may sell our common stock so loaned, or upon a default the broker-dealer may sell the pledged shares pursuant to this prospectus.

Broker-dealers or agents may receive compensation in the form of commissions, discounts or concessions from the selling stockholders. Broker-dealers or agents may also receive compensation from the purchasers of our common stock for whom they act as agents or to whom they sell as principals, or both. Compensation as to a particular broker-dealer might be in excess of customary commissions and will be in amounts to be negotiated in connection with our common stock. Broker-dealers or agents and any other participating broker-dealers or the selling stockholders may be deemed to be an underwriter within the meaning of Section 2(11) of the Securities Act of 1933 in connection with sales of the shares. Accordingly, any such commission, discount or concession received by it and any profit on the resale of our common stock purchased by it may be deemed to be underwriting discounts or commissions under the Securities Act of 1933. Because a selling stockholder may be deemed to be an underwriter within the meaning of Section 2(11) of the Securities

Act of 1933, the selling stockholders will be subject to the prospectus delivery requirements of the Securities Act of 1933. In addition, any securities covered by this prospectus which qualify for sale pursuant to Rule 144 promulgated under the Securities Act of 1933 may be sold under Rule 144 rather than pursuant to this prospectus. The selling stockholders have advised us that they have not entered into any agreements, understandings or arrangements with any underwriters or broker-dealers regarding the sale of their securities. There is no underwriter or coordinating broker acting in connection with the proposed sale of shares by the selling stockholders.

Our common stock will be sold only through registered or licensed brokers or dealers if required under applicable state securities laws. In addition, in certain states our common stock may not be sold unless they have been registered or qualified for sale in the applicable state or an exemption from the registration or qualification requirement is available and is complied with.

Under applicable rules and regulations under the Securities Exchange Act of 1934, any person engaged in the distribution of our common stock may not simultaneously engage in market making activities with respect to our common stock for a period of two business days prior to the commencement of such distribution. In addition, the selling stockholders will be subject to applicable provisions of the Securities Exchange Act of 1934 and the associated rules and regulations under the Securities Exchange Act of 1934, including Regulation M, which provisions may limit the timing of purchases and sales of shares of our common stock by the selling stockholders. We will make copies of this prospectus available to the selling stockholders and have informed them of the need for delivery of copies of this prospectus to purchasers at or prior to the time of any sale of our common stock.

We will file a supplement to this prospectus, if required, pursuant to Rule 424(b) under the Securities Act of 1933 upon being notified by the selling stockholders that any material arrangement has been entered into with a broker-dealer for the sale of shares through a block trade, special offering, exchange distribution or secondary distribution or a purchase by a broker or dealer. Such supplement will disclose:

- the name of such selling stockholder(s) and of the participating broker-dealer(s),
- the number of shares involved,
- the price at which such shares were sold,
- the commissions paid or discounts or concessions allowed to such broker-dealer(s), if any,
- that such broker-dealer(s) did not conduct any investigation to verify the information set out or incorporated by reference in this prospectus, and
- other facts material to the transaction.

We will bear all costs, expenses and fees in connection with the registration of our common stock. The selling stockholders will bear all commissions and discounts, if any, attributable to the sales of the shares. The selling stockholders may agree to indemnify any broker-dealer or agent that participates in transactions involving sales of the shares against certain liabilities, including liabilities arising under the Securities Act of 1933.

SELLING STOCKHOLDERS

The following table sets forth the name of the selling stockholders, the number of shares owned by the selling stockholders as of June 10, 2003, and the number of shares of our common stock expected to be owned by selling stockholders after this offering is completed. The number of shares in the column Number of Shares Being Offered represents all of the shares the selling stockholders may offer under this prospectus. We do not know how many shares or how long the selling stockholders may continue to offer under this prospectus. We do not know how long the selling stockholders will hold the shares before selling them, and we currently have no agreements, arrangements or understandings with the selling stockholders regarding the sale of any of the shares, except as indicated below. The shares being offered by this prospectus may be offered from time to time by the selling stockholders named below.

Name of Stockholders	Shares Beneficially Owned Prior to Offering Number	Shares Beneficially Owned Prior to Offering Percent	Number of Shares Being Offered	Shares Beneficially Owned After Offering** Number	Shares Beneficially Owned After Offering** Percent
National Union Fire Ins. Co. of Pittsburgh, Pa.	621,333	2.3	597,333	24,000	*
American Int. Specialty Lines Ins. Co.	522,457	2.0	522,457	0	0
First SunAmerica Life Insurance Co.	34,000	*	34,000	0	0
Northwestern Mutual Life Insurance Co.	53,959	*	53,959	0	0
American Family Mutual Insurance Co.	53,723	*	53,723	0	0
Massachusetts Mutual Insurance Co.	212,449	*	192,449	20,000	*
Pacific Life Ins. Co.	52,444	*	52,444	0	0
Principal Life Ins. Co.	149,909	*	149,909	0	0
Craig A. C. Reynolds	26,759	*	5,351	21,408	*

* Less than 1 percent.

USE OF PROCEEDS

Newtek Business Services, Inc. will not receive any of the proceeds from the sale of the shares by the selling stockholders.

BUSINESS

Newtek Business Services, Inc. is a holding company for several wholly- and majority-owned operating subsidiaries and certified capital companies, which we refer to as capcos, which provide a variety of complementary financial products and business services to small and medium-sized businesses. A chart describing our business is presented on page 4. We currently operate in three principal lines of business and we expect to begin operating in three additional complementary lines of business later in 2004. These six lines of business are as follows:

Certified capital companies. Historically, we have financed our operations and derived most of our revenue and income from state-sponsored capco programs and other related investments and operations. We have used capco funds to finance or acquire three of our five other operating businesses. A capco is a company we create pursuant to a state sponsored program, which is designed to encourage investment in small and new businesses in the state and to create economic activity and jobs in a designated geographic area. As an inducement to participation in the capco programs, each state provides a capco with tax credits to issue to its investors, which must be insurance companies. The tax credits are designed to be used to reduce the payment of taxes by the holder of those credits in the sponsoring state. The capco is then obligated to invest the funds raised pursuant to statutory requirements relating to such matters as size of the business, location, number of employees, etc. In the event that the capco does not comply with the performance requirements of the capco program, which are different in each state, the tax credits are subject to forfeiture. To date, the primary source of cash for Newtek itself has been the statutorily fixed, annual management fees of 2.5% of each capco s initial capital. The revenue to Newtek resulting from the capco tax credits is non-cash and is used exclusively to satisfy obligations of the capcos to deliver tax credits to their investors. Until our capcos have completed their business cycles and invested all of their funds, and we are able to distribute cash earnings of our capco businesses to the holding company, we must rely on the capco management fees and future earnings of non-capco investments, if any, as the sources of cash to meet our expenses.

Small business loans through participation in the SBA program. Through one of our operating subsidiaries, Newtek Small Business Finance, Inc., or NSBF, we make small business loans guaranteed by the U.S. Small Business Administration, or SBA. Our business clients use the loan proceeds to acquire commercial real estate, machinery, equipment and inventory, to refinance debt, to fund franchises, to acquire businesses and for working capital. NSBF is one of 14 companies licensed to provide SBA loans nationwide under the federal section 7(a) loan program for small businesses and the related section 504 business real estate loan program. John Cox, who spent 30 years at the SBA and was previously Associate Administrator for Financial Assistance, the senior official in charge of SBA lending, is Chairman and CEO of NSBF.

Payment processing solutions. Newtek Merchant Solutions offers credit card, debit card and gift card processing services and check approval services to approximately 5,000 small and medium-sized businesses through its four payment processing companies and its full service processing center in Wisconsin. In addition, Newtek Merchant Solutions provides these services to local and regional banks in Wisconsin, New York, Louisiana and Colorado that do not offer their own payment processing services so that these banks may offer these services to their merchant clients through Newtek.

Three new or reorganized lines of business which are expected to be fully operational during 2004:

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

small business tax services conducted by *Newtek Tax Services, LLC*, and

small business insurance, including property, casualty and life insurance to be provided through *Newtek Insurance Agency, LLC*.

Business Strategy

Key elements of our strategy to grow our business are:

Aggressively refocus our business model to serve the small and medium-sized business market. Over the last three years, we have refined our business model to focus primarily on developing and marketing products and services aimed at small and medium-sized businesses like those which we initially funded through our participation in capco programs. As our service offering grows and diversifies, we intend to continue to reduce our dependence on the capco programs as both a source of funding and correspondingly a source of revenue.

Further develop national recognition of the Newtek brand through marketing alliances. We have formed key marketing alliances with national business organizations such as Merrill Lynch and Cendant Corporation, business and trade organizations such as the Credit Union National Association and the Community Bankers of Wisconsin, and affinity organizations such as Revelation Corporation of America, Navy Federal Credit Union and the semi-public Veterans Corporation of America. These strategic partners, through their customers, members and participants, generate small business lending and payment processing business for us and build awareness of our brand name.

Cross-sell additional products and services to small- and medium-sized businesses. Our web based, proprietary Referral System is a custom designed customer relations management tool which allows us to utilize our alliance partners client base efficiently and cost effectively and assures our alliance partners full transaction transparency with the highest level of customer service.

Continue to develop our state-of-the-art technology to process business applications and financial transactions. Our applications processing technology allows us to process new business utilizing a web based system and a centralized processing point. Our trained representatives use these web-based applications as a tool to acquire and process data, eliminating the need for face to face contact and the requirement that a customer complete multiple paper forms. This approach is customer friendly, allows us to process applications very efficiently and allows us to store client information for further processing and future cross-selling efforts.

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

Continue to access the capco market as capco opportunities arise. We believe there is continued opportunity to use the capco programs as a funding source to facilitate the growth of our businesses.

Financial Highlights

During our year ended December 31, 2003:

the operation of the capcos resulted in non-cash revenues related to the capco tax credits of approximately $44.9 million, or 74% of total revenue. During 2002, the operation of the capcos resulted in non-cash revenues related to the capco tax credits of approximately $30.6 million, or 88% of total revenue.

Newtek Small Business Finance and Newtek Merchant Solutions generated aggregate revenues of approximately $13.7 million, or 23% of total revenue. During 2002, these business lines generated aggregate revenues of approximately $1.6 million, or 4.6% of total revenue.

We have experienced significant growth since 2000. The following highlights illustrate our growth in revenues and net income over the three year period.

For the year ended December 31, 2000, our total revenue was $8.7 million, compared to total revenues of $60.5 million for the year ended December 31, 2003, an increase of approximately 595%.

For the year ended December 31, 2000, we incurred a loss of $3.4 million, compared to net income of $9.6 million for the year ended December 31, 2003.

Over the three years ended December 31, 2003 invested in, operated and discontinued a number of small business ventures which were not producing acceptable results. Four of our business ventures, Newtek Business Exchange, Newtek IT Services, Newtek Strategies and Newtek Securities, continue to operate at modest levels with limited product offerings. Due to limitations on management talent and/or low levels of business activity, these ventures are not expected to produce any material revenue or profitability in the near future. These companies accounted for $783,000 in revenue and $1,496,000 in losses in 2003.

During 2003, our capcos invested an aggregate of $10.7 million. We determined that investments totaling $2.0 million had incurred an other than temporary impairment in value for the year ended December 31, 2003. Since beginning business in 1998, our capcos have invested an aggregate of $74.3 million, against which $5.3 million has been determined to be impaired. During 2003 we made no equity method investments and experienced no losses from previous equity method investments.

Certified Capital Companies

Overview. A capco is either a corporation or a limited liability company established in and chartered by one of the nine jurisdictions currently with authorizing legislation: Alabama, District of Columbia, Florida, Louisiana, Missouri, Colorado, New York, Texas and Wisconsin. Aside from seed capital provided by an organizer such as Newtek, a capco will issue debt and equity instruments exclusively to insurance companies, and the capcos then are authorized under the respective state statutes to make targeted equity or debt investments in companies, which in most cases may be majority-owned or primarily controlled by the capcos after the investments are consummated. In conjunction with the capcos investment in these companies, the capcos may also provide loans to the companies. In most cases, the tax credits provided by the states are equal to the amount of investment by the insurance companies in the securities of the capcos, which can be utilized by them over no less than ten years, or approximately 10% per year. These credits are unaffected by the returns or lack of returns on investments made by the capcos.

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

During 2002, we raised approximately $30 million through the issuance of capco notes and our common stock, and during 2003 we established one new capco or capco fund Wilshire Louisiana Partners IV, LLC, which raised approximately $6.9 million in October through the issuance of capco notes and our common stock.

The authorizing statutes in each of the states in which our capcos operate explicitly allow and encourage the capcos to take equity interests, which in most cases may include majority or controlling interests, in companies. Consequently, we may, consistent with our business objectives, acquire equity interests in companies through the use of the funds in the capcos and provide management and other services to these companies. The investments by the capcos create jobs and foster economic development consistent with the objectives of the programs as stated in most capco statutes. Furthermore, because our capcos have arranged for the repayment of a portion of the capco notes by The National Union Fire Insurance Company of Pittsburgh or The American International Specialty Lines Insurance Company, both affiliates of The American International Group, Inc., and a portion of the capco notes is paid through the delivery of tax credits, our capcos are under no pressure to generate short-term profits and may invest for long-term profitability. Some of our current majority-owned companies are less than four years old, and all but one produced a loss for 2003; Newtek Small Business Finance generated approximately $751,000 in pre-tax income for 2003. Due to the nature of the capco programs, we are able to accept the higher level of losses common to start up companies because we have the ability to devote the time, attention and resources to these companies which they require to become successful.

Because we use insurance to protect the principal of funds loaned to our capcos by insurance companies and in light of the cost of such insurance, in all of the capcos we have organized, after payment of the organizational costs and the capco insurance premium, the remaining cash is equal to approximately 50% of the amount initially raised. An important feature of all capco programs is that a minimum of 50% of the initial investment in the capcos must be placed in qualified business investments within a specified time, usually five years. As each capco receives repayment of debt plus interest, as well as receives return of and on equity investments, it is able to reinvest the funds in other qualified businesses, which may be its affiliated companies or others. It is through this investment-return-and- reinvestment process that our capcos are able to meet the minimum investment requirements of the capco programs. In 2001 our capcos received total repayments or returns of approximately $12.1 million, in 2002 they received approximately $14.0 million and in 2003 they received approximately $6.3 million. These funds supplemented the funds available for meeting minimum investment requirements. At December 31, 2003, 7 of our 10 operating capcos had met their respective minimum investment requirements. An eleventh capco was funded and began operations in January 2004 and is at the beginning of its business model, with the entire amount of its certified capital yet to be invested. On a cumulative basis through February 2004, our capcos have received insurance company funds of $184.6 million.

As of December 31, 2003, we are in full compliance with all of our capco funding requirements but have yet to invest approximately $9.1 million in order to satisfy all minimum investment requirements.

The recognition of revenue by our capcos represents our largest single source of revenue, equal to approximately 74% of our gross revenue in 2003, 88% in 2002 and 90.0% in 2001. This revenue was the principal source of our net income in 2003, 2002 and 2001.

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

We believe that we have built upon the resources of the capco programs to enhance the development of small business strategies in a manner which is more likely to be effective than if we had simply invested or loaned capco funds to an entrepreneur. Passive investment may have worked often enough in the business climate of the 1990 s, but businesses today, particularly small businesses, require much more than funds to succeed. In order to make the capco investments successful, and thus to fulfill the public policy objectives of the capco programs, we have enhanced the capco funding mechanism by actively adding management resources, technical, operational and professional expertise and non-capco funds. The services range from advice and assistance with strategic relationships to direct and daily involvement in policy making and management. This has included, for example, the development of the zero-cost NEWTEK branding for each of the operating companies, as well as the significant assistance that we provided to Newtek Small Business Finance in the negotiation of an extension of a $75 million credit line, which included a $3 million debt forgiveness and conversion of $1.5 million into preferred stock of the company. This was followed by the subsequent sale in January 2003 of $2 million in preferred stock to a unit of Credit Suisse First Boston Corporation in conjunction with a referral agreement for lending business.

Tax Credits. In return for the capcos making investments in the targeted companies, the states provide tax credits, generally equal to funds invested in the capco by the insurance companies, that are available for use by insurance companies that provide the funds to the capcos. In order to maintain its status as a capco and to avoid recapture or forfeiture of the tax credits, each capco must meet a number of specific investment requirements, including a minimum investment schedule. The occurrence of a final loss of capco status (i.e., decertification as a capco) could result in loss or possible recapture of the tax credit. To protect against such losses, our capcos have agreed with their funding insurance companies to provide, in the event of decertification, payments by the capco or, as described below, by the capco insurer to the insurance companies in the nature of compensatory payments to replace the lost tax credits.

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

Quantitative Requirements: These include minimum investment amounts and time periods for investment of certified capital (the amount of the original funding of the capco by the insurance companies). For example in the state of New York, a capco must invest at least 25% of its certified capital by 24 months from the initial investment date, 40% by 36 months and 50% by 48 months. The minimum investment requirements and time periods, along with the related tax credit recapture requirements are set out in detail below. See, also, Management s Discussion and Analysis -Income from Tax Credits and Note 1 of Notes to Consolidated Financial Statements Revenue Recognition of our Annual Report on Form 10-K, incorporated herein. The minimum requirements are calculated on a cumulative basis and allow the capcos to receive a return of an investment and re-invest the funds for full additional credit towards the minimum requirements.

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

Enforcement of Requirements: The various states, which administer these programs through their insurance, banking or commerce departments, conduct periodic reviews and on site examinations of the capcos in order to verify that the capcos have met applicable investment requirements and are otherwise acting in conformance with the statutes and rules. Capcos are required to maintain detailed records so as to demonstrate to state examiners compliance with all applicable requirements. A failure of a capco to meet one of the statutory minimum *quantitative* investment benchmarks within the time specified would constitute grounds for the loss of the capco s status, or its decertification, and the loss and recapture of some or all of the tax credits previously passed through the capco to its investors. A decertification of one of our capcos would have a material adverse effect on our business in that it would require the capco insurer to make compensatory payments equal to the lost tax credits and would permit the insurer to assume control over the assets of the capco in order to cover its losses. Compliance with these requirements is reflected in contractual provisions of the agreements between each capco and its investors. The capcos covenant to their investors to use the funds only for investments as permitted by the capco laws or for related expenses and to refrain from taking any action which would cause the capco to fail to continue in good standing.

Compliance: As of the end of 2003, all of our capcos were in compliance with all applicable requirements and 7 of the 10 operational capcos (a 11th was formed in January 2004) had met their final, minimum 50% investment thresholds. This eliminates any material risk of decertification and tax credit recapture or loss for its insurance company investors in these capcos. This represents approximately $121.2 million of tax credits, or about 77% of the tax credits associated with all of our capcos. See: Investment Requirements and Capco Cash.

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

Investment Requirements and Capco Cash. In order to address the risk of decertification, which may generally be eliminated by meeting a 50% of capital investment threshold, we have structured our capco investment program, consistent with safe and sound operations, so as to meet the investment benchmarks as early as possible. The table below presents the cash positions of each of our capcos at organization, consisting of:

- initial cash receipts from insurance companies (certified capital),
- plus other cash proceeds, consisting of:
  - initial seed money provided by us: $3.9 million (through January 2004); and
  - premiums paid by investing insurance companies in excess of the face amount of the capco notes to adjust the instruments to the then current market values: $17.0 million;
- plus amounts financed for the payment of insurance premiums; and
- less payments for capco insurance policies.

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

The result as shown on the following chart, in the column Net Cash Available to Invest, demonstrates, that in all cases except four, the amount of cash available for investment by the capcos exceeded by minimal amounts the minimum 50% investment benchmarks. The final column demonstrates the aggregate of investments by each of the capcos and indicates the amount of minimum investment remaining to be made as of December 31, 2003. At that date seven of the capcos had exceed the 50% minimum investment requirement. The three other capcos had a total of approximately $10 million of remaining minimum investment yet to be satisfied.

CASH AVAILABLE TO EACH CAPCO AT ORGANIZATION and

REMAINING MINIMUM REQUIRED INVESTMENT

Capco Name & Year of Organization	**Certified Capital**	**Other Cash Proceeds (1)**	**Other Capco Debt**	**Premium Coverage A**	**Premium Coverage B**	**Net Cash Available to Invest**	**50% Minimum Investment**	**Minimum Remaining at 12/31/03**
1998								
WA (2)	$ 2,673,797	$ 500,000		$ 1,647,905	$ 157,694	$ 1,368,198	$ 1,336,899	**None**
1999								

WP (2)	37,384,028	2,446,773		23,127,927	3,998,948	12,703,926	18,692,011	**None**
WLA (2)(3)	16,400,000	2,051,020	2,000,000	9,175,844	2,193,741	9,081,435	8,200,000	**None**
WI (2)	16,666,667	1,479,236	2,000,000	9,086,227	2,352,786	8,706,890	8,333,334	**None**
2000								
WNYII (2)	6,807,866	1,380,000	1,500,000	5,019,803	504,745	4,163,318	3,403,933	**None**
WA (2)	1,136,364	115,266		661,432	160,068	430,130	568,182	**None**
WLPII (2)(3)	3,050,000	1,248,274	300,000	2,456,565	319,958	1,821,751	1,525,000	**None**
WNYIII (2)	35,160,202	9,893,394	5,200,000	29,052,790	4,137,438	17,063,368	17,580,101	**None**
2002								
WCOL	22,057,767	1,236,733	2,000,000	11,654,021	3,604,978	10,035,501	11,028,884	4,693,907
WLPIII	8,000,000		1,000,000	2,859,644	1,089,134	5,051,222	4,000,000	1,000,000
2003								
WLP IV	6,800,000	95,200	1,000,000	2,533,722	1,093,216	4,268,262	3,400,000	3,400,000

(1) We have invested a minimum of $500,000 in cash in seven of eleven operational capcos; in the four capco and capco funds in Louisiana we invested $260,000 because the second, third and fourth capcos (investment pools) have been structured as permitted by the unique provisions of that state s statute be able to utilize the capital of the first Louisiana capco to meet the initial capital requirements. Other Cash Proceeds consist of this initial funding by us of $3,400,000, out of cash on hand, plus in some cases a market rate adjustment paid in cash by the certified investors to conform the imputed return on the capco notes to then current market rates.

(2) At December 31, 2003 these seven capcos have met their minimum investment benchmark of 50% of Certified Capital and, therefore, all related tax credits are beyond recapture or forfeiture. Stated another way, $121 million in tax credits, or approximately 77% of the total of all capcos, are irrevocably beyond recapture or forfeiture. In all cases, the minimum investment benchmarks were met 12 months or more in advance of the statutory minimum investment benchmark dates.

(3) Tax credits allocated in these three Louisiana programs were calculated at 110% of certified capital. The numbers presented, however, are the amounts of the Certified Capital (cash) actually received by the capco at funding.

Exponential of New York, LLC, or Exponential, LLC, is structured differently than our other capcos and is not covered by capco insurance as are our other capcos. We do not own this capco. We acquired 100% of an entity that has a less than 20% ownership in Exponential, LLC and, as such, we use the cost method of accounting for this investment; the balance of the equity of this capco is owned by Utica Insurance Company.

Exponential, LLC did not purchase any insurance with respect to its obligations. Instead, it purchased and pledged discounted United States Treasury obligations that will increase in value over ten years to equal the amount of principal owed to Utica Insurance Company in repayment of Exponential, LLC s initial funding. At December 31, 2003, 2002 and 2001, respectively, Exponential had total assets of $9,563,630, $9,700,361 and $7,522,911, and at the same dates it held $3,083,176, $2,897,394 and $2,722,811 in Treasury obligations.

Principal Operating Businesses

The structures through which we own and manage our operating, or non-capco, lines of business can be divided broadly into two categories: (1) those which are majority-owned and (2) those which we either primarily control through lesser equity positions or contractual rights or in which we have a passive or venture-type investment. At December 31, 2003, we had sixteen majority-owned companies through which we conduct our principal business activities, all of which were as a result of investments through the capco programs. All of these businesses were initially financed primarily by capco funding and are located and operated by business professionals located in the respective states.

Majority-Owned Companies

Small Business Lending

We acquired Newtek Small Business Finance, Inc., or NSBF, on December 31, 2002 through a combination of capco funding and cash and non-cash resources that we provided. NSBF specializes in making small business loans guaranteed by the SBA for the purpose of acquiring commercial real estate, machinery, equipment and inventory and to refinance debt, fund franchises, working capital and business acquisitions. This lending is both direct and through various financing partners. NSBF is one of 14 companies licensed to provide loans nationwide under the federal section 7(a) loan program for small businesses and the related section 504 business real estate loan program. Historically, these two federal programs account for approximately $10 billion and $3 billion of loans each year.

Prior to our acquisition and recapitalization of NSBF, this small business lender had been poorly managed and plagued by bad loans. When we purchased NSBF, it had a negative stockholders equity. Over the course of the previous year, we and the new NSBF management team had carefully reviewed the problems and prepared a detailed plan for the operations of the company post-closing. In addition to new management and the capital infused by the capco investment, we were able to negotiate a renewal and extension of a critical $75 million warehouse lending line of credit from Deutsche Bank in conjunction with a conversion of a portion of the outstanding debt for equity. Immediately following the purchase, we arranged for an additional $2 million investment in NSBF by an affiliate of Credit Suisse First Boston.

During 2003, NSBF focused on its integration into Newtek and developing a technologically advanced loan application and processing program along with Harvest Strategies, LLC (d/b/a Newtek Strategies), another of our affiliated companies. These program tools guide business owners step-by-step through the loan application process and enable them to be pre-qualified for a small business loan by completing an on-line application. These program tools are distinguishable from competitive products due to their ability to be private-labeled and utilized on the websites of third parties. NSBF s private label online application system is a strong marketing tool, providing advantages in executing the strategy of penetrating the customer bases of our marketing alliance partners. These marketing alliances with strategic partners are an essential part of our business strategy to open up broad groups of small- and medium-sized businesses to our principal operating businesses. We have these arrangements with national business organizations such as Merrill Lynch and Cendant Corporation, business and trade organizations such as the Credit Union National Association and the Community Bankers of Wisconsin, and affinity organizations such as Revelation Corporation of America, Navy Federal Credit Union and the semi-public Veterans Corporation of America.

Also during 2003, NSBF developed an expanded management team with significant experience in the small business lending market. John Cox, NSBF s Chairman and CEO, was previously Associate Administrator for Financial Assistance at the SBA. In this capacity, Mr. Cox was the senior management official in charge of all SBA business lending. Mr. Cox had a 30-year career with the SBA. Michael Dowd, NSBF s Chief Operating Officer, worked for the SBA for 25 years and was National Director for Loan Programs where he was responsible for formulation of all policies and procedures governing the implementation of the 7(a) and 504 loan programs, including all loan making, loan servicing, loan monitoring and review functions. During 2003, NSBF hired Peter Downs as NSBF s President. Mr. Downs spent 16 years in various small business lending roles within the banking industry, most recently as National Director of SBA lending for Citibank, coordinating SBA underwriting and sales for Citibank nationwide.

At December 31, 2003, NSBF had funded 47 loans for a total of $25.1 million, and was servicing a portfolio of loans for others totaling $123.8 million. NSBF was the only one of our majority controlled companies which showed pre-tax income for 2003, which was approximately $751,000.

Electronic Payment Processing

We conduct our electronic payment processing business nationwide through five majority-owned companies which offer credit card, debit card and gift card processing services and check approval services to approximately 5,000 small businesses. These five subsidiaries are described below.

Universal Processing Services Wisconsin, LLC, d/b/a Newtek Merchant Solutions of Wisconsin, or UPS-WI, provides credit card, debit card, gift card processing and check approval services directly to merchants. UPS-WI obtains the majority of its merchant customers through agreements with independent sales organizations, including our affiliates below, and other associations throughout the country which then contract with UPS-WI to provide processing services. UPS-WI pays these organizations and associations a percentage of the processing revenue derived from their respective merchants. UPS-WI assists merchants with their initial installation of equipment and initial and on-going service and any other special processing needs that they may have. On a wholesale basis, UPS-WI acts as a processor for merchants that are brought to it through our affiliated companies and other third-party marketing organizations. UPS-WI had contracts with 100 independent sales consultants as of December 31, 2003, and has grown its customer base significantly during 2002 and 2003.

UPS-WI is currently adding approximately 225 electronic payment processing customers per month and has reached a customer base of approximately 2,500 as of December 31, 2003. Because of the growth experienced in 2003, UPS-WI had positive cash flow and earnings for the last quarter of 2003.

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

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

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

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

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

Since inception, UPS-NY, UPS-LA and UPS-CO have all experienced operating losses in each year of operations. These losses have been primarily attributable to general corporate overhead and compensation and commissions paid, which together have been greater than the revenues generated on an annual basis. Based upon the continued growth of the customer bases of these companies, we expect all will turn profitable due to increases in monthly residual payments in the near future.

Automated Merchant Services, Inc., or AMS, based in Coral Springs, Florida, was acquired by our Florida capco and us in August 2003 for a combination of cash and stock. As do our other four electronic payment processing subsidiaries, AMS provides electronic payment services, hardware and software to approximately 2,500 businesses and government agencies through ten sales representatives covering the Florida marketplace. During 2003, AMS added 60-70 new clients every month. We plan on assisting AMS to grow beyond the Florida market and to expand its product base to include all of the products and services that our existing processor, UPS-WI, offers. Over time, we expect that AMS will be re-branded as a part of Newtek Merchant Solutions and marketed in conjunction with our other business services and financial products.

Financial Information Systems

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

Group Management Technologies, LLC, d/b/a Newtek Financial Information Systems of Florida, or GMT, is based in Florida and provides administrative and technological support for small businesses by designing and implementing specialized financial and management reporting systems and by providing outsourced financial management functions that reduce costs and management requirements for its clientele. GMT targets the market segment of businesses that are too small to afford a full time financial executive but have grown to the point where managerial and financial controls must be introduced in order to effectively grow the business. GMT s specialists work closely with management to create budgets and forecasts that serve as planning tools as well as performance evaluation and control benchmarks.

Since inception in November 1999, GMT has experienced operating losses in each year of operations due to historically low revenue in relation to its expenses. While GMT has been unable to build a client base beyond the Newtek affiliated companies, we believe that our financial information system offerings are well designed and technologically advanced and will, with proper management and marketing, be able to contribute both revenue and profit to us in the future.

Group Management Technologies of Louisiana, LLC, d/b/a Newtek Financial Information Systems of Louisiana, or GMT-LA, was organized in December 2002 and is based in Louisiana. GMT-LA is engaged in the same line of business as is GMT. We anticipate that in the future GMT-LA will contract with GMT for some of the services that are supplied to its clients. Since inception, GMT-LA has experienced losses, and accordingly we are restructuring both its business plan and management team.

Global Business Advisors of Wisconsin, LLC, d/b/a Newtek Capital Advisers of Wisconsin, or GMT-WI, was organized in December 2003 and is based in Wisconsin. GMT-WI is engaged in the same line of business as is GMT. We anticipate that in the future GMT-WI will contract with GMT and other affiliated entities for some of the services that are supplied to its clients.

Small Business Tax Services

Newtek Tax, LLC was formed in 2003 to provide tax filing, preparation and advisory services to small and medium sized businesses. Newtek Tax provides comprehensive tax services that are customized to fit the unique needs of each client. With specialists available in many different areas of tax-related expertise, we believe that Newtek Tax offers a significant depth of resources. Newtek Tax has licensed what it believes to be state-of-the-art software to prepare returns. Because Newtek Tax was formed during the latter portion of 2003, it did not provide any material financial results for the year ended December 31, 2003. Newtek Tax intends to market its products to customers of all our affiliated companies utilizing the Newtek Referral System.

Small Business Insurance Products and Services

The Newtek Insurance Agency, LLC was established in Washington, D.C., in 2003 by us without using capco funds. Our plans are for Newtek Insurance Agency to serve as a retail agency and to market its products to customers of all our affiliated companies. When it begins operations, we expect it to provide customized business insurance products for small- and medium-size businesses, including key man life, accident and health, business owners protection and property and casualty insurance. It is currently fully licensed in 42 states, with the intention to be licensed in all 50 states. We anticipate that this business will also use our web based centralized processing system.

Newtek Insurance Agency will be headed by Ellen Abromson, currently an attorney with the District of Columbia office of a prominent national law firm and a District of Columbia-licensed insurance producer with life and health, property and casualty, and personal lines designations. Previously, Ms. Abromson served for nine years as an in-house attorney for the Acacia Group of Financial Services Companies, a firm that marketed its own life and variable life insurance products and distributed numerous other insurance products through a captive field force and independent agents. Newtek Insurance Agency did not generate any revenue during 2003 and anticipates commencing insurance brokerage operations in the second or third quarter of 2004.

Other Business Lines

Exponential Business Development Company, Inc., or Exponential, was originally organized in the mid-1990s to participate in the New York State capco program (as a competitor of Newtek). It had structured Exponential, LLC, differently than us, with ownership being sold to the insurance company investors and a small equity portion retained by Exponential, which acted as the manager. The capco has made 11 small equity investments and 3 additional investments of both debt and equity. Exponential has also organized another investment vehicle Exponential of New York, LP, that has made six equity investments and two others involving debt. Our interest in Exponential was due to the high reputation of

agreement under which each agreed, or will agree, not to sell, pledge or hypothecate the merger stock until on or after December 31, 2011 or, in the case of executive officers or directors of BioSciences and executive officers of Ampio, until February 29, 2012. As required by the merger agreement, at the closing BioSciences donated back to Ampio s capital 3,500,000 shares of Ampio common stock formerly owned by BioSciences. Ampio separately issued 212,693 options in replacement of 250,850 Biosciences options that were out-of-the-money as of the date of execution of the merger agreement.

As a component of the purchase price, Ampio recorded a liability of $574,000 to reflect the potential settlement with three in-the-money option holders that threatened litigation to have their BioSciences options carried over versus being issued Ampio stock in exchange for these options. The dispute involves 263,000 options that were converted to 98,416 shares of Ampio common stock. The liability is estimated based on a fair value calculation of the difference between the Ampio stock trading price and the value of Ampio options using the Black-Sholes option price model with an exercise price of $0.90. A verbal agreement was reached to settle the dispute on May 5, 2011. See Note 11 Subsequent Events.

The following table summarizes the amounts of estimated fair value of net assets acquired at the acquisition date:

Notes receivable from Ampio	$ 300,000
Non-interest bearing advances and accrued interest receivable from Ampio	127,000
In-process research and development	7,500,000
Patents	500,000
Liabilities	(574,000)
	$ 7,853,000

BioSciences had Net Operating Loss (NOL) carryforwards for federal and state income tax purposes of approximately $11,200,000 which expire from 2016 through 2030. Under the provisions of the Internal Revenue Code, substantial changes in BioSciences ownership may result in limitations on the amount of the NOL carryforwards which can be utilized in future years. Ampio provided a full valuation allowance against BioSciences $4,600,000 deferred tax asset (primarily associated with the NOL carryforwards), based on the weight of available evidence, both positive and negative, which indicated that it is more likely than not that such benefits will not be realized.

Note 4 Short Term Debt / Debenture Conversion

Related Party Notes Payable

As of December 31, 2010, Ampio had $300,000 in related party notes payable to BioSciences, Inc. (BioSciences) and $100,000 to a director. The related party notes payable and accrued interest owed to BioSciences were eliminated in consolidation subsequent to the acquisition of BioSciences. The $100,000 related party notes payable to a director was repaid together with accrued interest of $8,219 on March 31, 2011.

Senior Convertible Unsecured Related Party Debentures

On February 28, 2011, the holders of the Senior Convertible Unsecured Debentures with related parties (the Related Party Debentures) converted principal and accrued interest receivable of $430,000 and $18,102, respectively, into 256,058 shares of common stock a $1.75 per share.

Ampio issued additional warrants in the first quarter of 2011 to purchase 2,069 shares of common stock in connection with the accrued interest associated with the Related Party Debentures. The warrants expire on December 31, 2013. The exercise price became fixed at $1.75 per share on March 31, 2011. The warrants are subject to adjustment for recapitalization events. The warrants are described more fully in Note 8 Common Stock.

Senior Unsecured Mandatorily Redeemable Debentures

Ampio issued Senior Unsecured Mandatorily Redeemable Debentures (the Redeemable Debentures) with a face value of $382,000 between January 20, 2011 and January 31, 2011 on the same terms as the Redeemable Debentures with a face value of $1,381,000 issued between October 22, 2010 and December 29, 2010. The holders of the Redeemable Debentures converted principal and accrued interest totaling $1,763,000 and $32,146, respectively into 1,025,794 shares of common stock on February 28, 2011.

Table of Contents

Ampio issued additional warrants to purchase 43,657 shares of common stock in connection with the sale of Redeemable Debentures in January 2011. Ampio also issued warrants to purchase 3,674 shares of common stock in satisfaction of the accrued interest on the Redeemable Debentures issued in 2010 and 2011. The warrants issued in connection with the Redeemable Debentures have an expiration date of December 31, 2013. The exercise price of the warrants has been set at $1.75. The warrants are subject to adjustment for recapitalization events. The warrants are described more fully in Note 8 Common Stock.

Accounting for the Financings

Because the economic characteristics and risks of the equity-linked conversion options are not clearly and closely related to a debt-type host, the conversion features require classification and measurement as a derivative financial instrument. The other embedded derivative features (down round protection feature and mandatory conversion provision) were also not considered clearly and closely related to the host debt instrument. Further, these features individually were not afforded the exemption normally available to derivatives indexed to a company s own stock. Accordingly, Ampio s evaluation resulted in the conclusion that a compound derivative financial instrument requires bifurcation and liability classification, at fair value. The compound derivative financial instrument consists of (i) the embedded conversion feature, (ii) down round protection feature and (iii) mandatory conversion provision. Current standards contemplate that the classification of financial instruments requires evaluation at each report date.

GAAP provides an election wherein companies that issue financial instruments with embedded features that require bifurcation may elect, as an alternative to bifurcation, fair value measurement of the hybrid financial instrument in its entirety. After reviewing all circumstances surrounding the issuance and impending redemptions or conversions, Ampio elected the alternative and recorded the Senior Convertible Debentures at fair value.

Ampio also concluded that the Warrants, which are derivatives by definition, did not meet the principal exemption to liability classification and measurement. Generally, freestanding financial instruments such as the Warrants that are both indexed to a company s own stock and classified in stockholders equity under certain conditions are exempt from derivative classification and measurement standards. The Warrants did not meet the definition of indexed to a company s own stock on the inception date because the exercise price was subject to adjustment. The Warrants also did not meet all of the eight conditions for classification in stockholders equity. Accordingly, the Warrants are classified as a liability and subject to the classification and measurement standards for derivative financial instruments.

The following table reflects the allocation of the tranche of Redeemable Debentures and related warrants purchased in January, 2011 and the warrants issued in February 2011 in connection with accrued interest on the Related Party Debentures and the Redeemable Debentures:

	Redeemable Debentures (a)	Accrued Interest (b)
Purchase price allocation		
Hybrid debt instruments	$ 1,096,064	
Warrants	211,073	233,933
Derivative loss, included in derivative expense	(925,137)	(233,933)
	$ 382,000	$

Notes:

(a) Issuance dates were between January 20 and January 31, 2011.
(b) Issuance date was February 28, 2011.

Table of Contents

Note 5 - Derivative Financial Instruments

The components of warrant derivative liability as reflected in the balance sheet as of March 31, 2011:

	Warrant Shares	Fair Value
Ampio s financings giving rise to derivative financial instruments:		
Warrants (dates correspond to hybrid financing):		
Tranche 1 - August 10, 2010	51,215	$ 129,966
Tranche 2 - October 22, 2010-October 29, 2010	24,625	59,931
Tranche 3 - November 12, 2010-November 29, 2010	122,968	300,064
Tranche 4 - December 13, 2010-December 29, 2010	13,686	33,711
Tranche 5 - January 20, 2011-January 31, 2011	43,895	109,390
	256,389	$ 633,062

Both the warrants and the conversion options embedded in the hybrid debt instruments were valued using a binomial-lattice-based valuation model. The lattice-based valuation technique was utilized because it embodies all of the requisite assumptions (including the underlying price, exercise price, term, volatility, and risk-free interest-rate) that are necessary to fair value these instruments. For forward contracts that contingently require net-cash settlement as the principal means of settlement, Ampio projects and discounts future cash flows applying probability-weighting to multiple possible outcomes. Estimating fair values of derivative financial instruments requires the development of significant and subjective estimates that may, and are likely to, change over the duration of the instrument with related changes in internal and external market factors. In addition, option-based techniques are highly volatile and sensitive to changes in the trading market price of Ampio s common stock, which has a high-historical volatility.

Since derivative financial instruments are initially and subsequently carried at fair value, Ampio s income will reflect the volatility in these estimates and assumption changes.

The following table summarizes the effects on Ampio s unrealized (gain) loss associated with hybrid debt instruments recorded at fair value by type of financing for the three months ended March 31, 2011:

Warrants (dates corresponding to financing)	
Tranche 1 - August 10, 2010	$ 81,209
Tranche 2 - October 22, 2010-October 29, 2010	5,946
Tranche 3 - November 12, 2010-November 29, 2010	28,715
Tranche 4 - December 13, 2010-December 29, 2010	9,131
Tranche 5 - January 20, 2011-January 31, 2011	(101,683)
	23,318
Day-one derivative expense:	
Tranche 5 - January 20, 2011-January 31, 2011	925,137
	$ 948,455

Table of Contents

The following table summarizes the effects of Ampio s unrealized loss associated with hybrid financial instruments recorded at fair value by type for the three months ended March 31, 2011:

Tranche 1 - August 10, 2010	$ 1,245,707
Tranche 2 - October 22, 2010-October 29, 2010	578,744
Tranche 3 - November 12, 2010-November 29, 2010	2,901,987
Tranche 4 - December 13, 2010-December 29, 2010	330,829
Tranche 5 - January 20, 2011-January 31, 2011	528,155
	$ 5,585,422

The following table summarizes activity in the warrant liability during the three months ended March 31, 2011:

Balance December 31, 2010	$ 398,671
Day-one derivative expense related to warrants in tranche 5 - January 20, 2011 - January 31, 2011 of hybrid financing	211,073
Increase in fair value of 256,389 warrants	23,318
Balance March 31, 2011	$ 633,062

Note 6 Fair Value Considerations

Ampio s financial instruments include cash and cash equivalents, prepaid expenses, accounts payable, accrued salaries, accrued interest payable, related party payable, related party notes payable, senior convertible unsecured related party debentures, senior unsecured mandatorily convertible debentures (hybrid debt instruments, which include embedded derivative features) and warrant derivative liability. The carrying amounts of cash and cash equivalents, prepaid expenses, accounts payable, accrued salaries, accrued interest payable, related party payable, and related party notes payable approximate their fair value due to their short maturities. Derivative financial instruments, as defined by GAAP, consist of financial instruments or other contracts that contain a notional amount and one or more underlying (*e.g.* interest rate, security price or other variable), require no initial net investment and permit net settlement. Derivative financial instruments may be free-standing or embedded in other financial instruments. Further, derivative financial instruments are initially, and subsequently, measured at fair value and recorded as liabilities or, in rare instances, assets, with changes in fair value recorded in earnings.

Ampio generally does not use derivative financial instruments to hedge exposures to cash-flow, market or foreign-currency risks. However, Ampio has entered into certain other financial instruments and contracts, such as Ampio s secured convertible debenture and warrant financing arrangements that are either (i) not afforded equity classification, (ii) embody risks not clearly and closely related to host contracts, or (iii) may be net-cash settled by the counterparty. As required by GAAP, these instruments are required to be carried as derivative liabilities, at fair value, in Ampio s financial statements. However, Ampio may elect fair value measurement of the hybrid financial instruments, on a case-by-case basis, rather than bifurcate the derivative. Ampio believes that fair value measurement of the hybrid convertible debenture financing arrangements provide a more meaningful presentation. See Note 5 Derivative Financial Instruments for additional information about derivative financial instruments.

Authoritative guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. The guidance establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of Ampio. Unobservable inputs are inputs the reflect Ampio s assumptions of what market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on reliability of the inputs as follows:

Level 1: Inputs that reflect unadjusted quoted prices in active markets that are accessible to us at the measurement date for identical assets or liabilities;

Table of Contents

Level 2: Inputs include quoted prices for similar assets and liabilities in active or inactive markets or that are observable for the asset or liability either directly or indirectly; and

Level 3: Unobservable inputs that are supported by little or no market activity.

Ampio s assets and liabilities which are measured at fair value are classified in their entirety based on the lowest level of input that is significant to their fair value measurement. Ampio s policy is to recognize transfers in and/or out of fair value hierarchy as of the date on which the event or change in circumstances caused the transfer.

The following table presents Ampio s financial assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2011 and December 31, 2010, by level within the fair value hierarchy:

	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
March 31, 2011				
ASSETS				
Money market funds (included in cash and cash equivalents)	$ 3,783,716	$	$	$ 3,783,716
LIABILITIES				
Warrant derivative liabilities			633,062	633,062
December 31, 2010				
ASSETS				
Money market fund (included in cash and cash equivalents)	$ 168,876	$	$	$ 168,876
LIABILITIES				
Hybrid debt instruments			2,133,743	2,133,743
Warrant derivative liabilities			398,671	398,671

The warrant derivative liability for the warrants associated with debt was valued using the binomial lattice-based valuation methodology because that model embodies all of the relevant assumptions that address the features underlying these instruments. Significant assumptions were as follows as of March 31, 2011:

Exercise price	$ 1.75
Volatility	205%
Equivalent term (years)	2.37 - 2.82
Risk-free interest rate	1.29%

The warrant derivative liability for the warrants associated with debt was valued using the binomial lattice-based valuation methodology because that model embodies all of the relevant assumptions that address the features underlying these instruments. Significant assumptions were as follows as of the inception dates:

Exercise price	$ 1.75
Volatility	205%
Equivalent term (years)	2.47 - 2.92
Risk-free interest rate	1.29%

Table of Contents

The following table sets forth a reconciliation of changes in the fair value of financial liabilities classified as Level 3 in the fair valued hierarchy:

	Derivative and Hybrid Debt Insturments	
	2011	2010
Balance as of January 1	$ (3,141,260)	$
Total losses (realized or unrealized)		
Included in earnings	(6,533,877)	
Debenture conversions	9,424,075	
Debenture issuances	(382,000)	
Balance as of March 31	$ (633,062)	$

Note 7 Commitments and Contingencies

Ampio entered into a clinical research agreement with a hospital and a physician investigator, (collectively, the Parties) effective April 1, 2010. Under the terms of the clinical research agreement, Ampio agreed to fund and support a clinical trial to a minimum of $657,000 based up on a budget to be agreed upon by the Parties. Ampio has made payments to the hospital of $100,000 through March 31, 2011. The clinical research agreement will remain in full force until the clinical trial is completed or until terminated by one of the Parties. In conjunction with the clinical trial, Ampio entered into a master services agreement with a pharmaceutical contract research organization to provide data management and statistical services for a total of $134,415, of which Ampio paid $12,500 in 2010 and $10,087 in the three months ended March 31, 2011.

Ampio entered into clinical research agreements to begin clinical trials in Australia. Ampio has agreed to contracts calling for total payments of $80,350 of which $23,584 had been paid at March 31, 2011.

During August 2010, Ampio entered into employment agreements with three of its officers. Under the employment agreements, the officers are collectively entitled to receive $571,000 in annual salaries. Upon completion of a financing of $5,000,000 or more, the annual salaries will collectively increase to $825,000. With the completion of the private placement as indicated in Notes 8 and 11, these salaries were increased effective April 1, 2011. The employment agreements have terms of three years.

Ampio entered into a Sponsored Research Agreement with Trauma Research LLC, a related party, in September 2009. Under the terms of the Sponsored Research Agreement, Ampio is to provide personnel and pay for leased equipment. The Sponsored Research Agreement may be terminated without cause by either party on 180 days notice. Obligations under the Sponsored Research Agreement are as follows:

2011	$ 197,813
2012	263,750
2013	263,750
2014	175,833
	$ 901,146

Ampio leases its offices under a non-cancellable operating lease expiring in 2011. The remaining obligation under this non-cancellable operating lease is $17,956.

15

Note 8 Common Stock

Capital Stock

At March 31, 2011 and December 31, 2010, Ampio had 100,000,000 shares of common stock authorized with a par value of $0.0001 per share, and 10,000,000 shares of preferred stock authorized with a par value of $0.0001 per share.

Private Placement Offering

On March 31, 2011, Ampio closed the first round of a private placement of its common stock. A total of 2,509,447 shares of common stock were issued on March 31, 2011, resulting in gross proceeds of $6,273,618, of which the Company received net proceeds of $5,388,862, after placement agent commissions, non-accountable expenses and other offering costs. The placement agent also received 250,944 warrants in connection with the closing valued at $422,657 which amount has been included in total offering costs in the statement of change in stockholders equity (deficit). See Note 11 - Subsequent Events regarding the April 2011 completion of the private placement offering.

Capital Transactions

Life Sciences issued 1,080,000 shares of Common Stock to its founder in December 2008 at a value of $.001 per share.

Life Sciences issued 3,500,000 shares of Common Stock to BioSciences in April 2009 in connection with an Asset Purchase Agreement. Under the terms of the agreement, Life Sciences acquired office and lab equipment, cell lines and intellectual property including patents and license agreements. While Life Sciences valued those assets in excess of $300,000, for financial reporting purposes the assets and liabilities have been recorded at predecessor cost. In conjunction with the asset purchase, Life Sciences recorded a distribution of $252,015 to reflect liabilities assumed. Included in the assumed liabilities was a $200,000 note payable to Life Sciences founder. The note payable was converted into 163,934 shares of Series A preferred stock at a value of $1.22 per share.

Life Sciences issued 7,350,000 shares of restricted Common Stock to its directors, officers and employees in exchange for $7,350 in cash in April 2009. The restricted common stock is subject to vesting as set forth below under Restricted Common Stock.

Life Sciences issued 913,930 shares of Series A Preferred Stock in April and May 2009 in exchange for $1,115,020 in cash.

Life Sciences received $170,003 in December 2009 in connection with a private placement for the purchase of 97,144 shares of common stock. Life Sciences had not issued the shares as of December 31, 2009 and therefore recorded the proceeds as a liability. The shares were issued in 2010.

As set forth in Note 1 Business, Basis of Presentation and Merger, Life Sciences and Chay completed a reverse merger in March 2010, and Chay changed its name to Ampio Pharmaceuticals, Inc. In conjunction with the Merger, Life Sciences Series A Preferred Stock was automatically converted into common stock. As result of the Merger, related stock transactions and the conversion of Series A Preferred Stock, Ampio common stock outstanding increased by 3,068,958 shares.

Ampio issued 1,078,078 shares of common stock in March and April, 2010 for $1,536,630 in cash (net of $350,000 in offering costs), of which $7,000 had been received in March 2010 and $170,003 had been received in 2009 and was initially classified as common stock subscribed.

Ampio issued 1,030,000 shares of common stock in January, February and March 2010 in exchange for services. The shares were recorded at their fair value, $1.75 per share or $1,802,500. Ampio recorded $1,799,219 as expense in 2010 see Note 9 Stock Based Compensation. The remaining $3,281 is reflected as a deferred charge in stockholders equity, and will be recognized into expense as the services are provided.

As further discussed in Note 3 Acquisition of DMI BioSciences, 8,667,905 shares of Ampio common stock were issued on March 23, 2011. At that time, the 3,500,000 shares issued in April, 2009 to BioSciences in connection with the asset purchase were surrendered back to Ampio for cancellation.

Restricted Common Stock

Total shares of 7,350,000 owned by Ampio s employees are restricted. One third of the restricted shares vested on the date of grant, April 17, 2009. The remaining two thirds vest on a monthly basis between the first and second anniversaries of the date of grant. Vesting is subject to acceleration upon achieving certain milestones. See Note 11 - Subsequent Events.

Table of Contents

Equity Incentive Plan

Ampio adopted a stock plan in March 2010. During August of 2010, the number of shares of common stock reserved for issuance to officers, directors, employees and consultants through various means, including incentive stock options, non-qualified stock options, restricted stock grants, and other forms of equity equivalents, was increased from 2,500,000 to 4,500,000. Ampio granted options to purchase 2,930,000 shares in August of 2010, of which 1,820,000 vested immediately, and the remaining 1,110,000 options vest annually over two years. During the three months ended March 31, 2011, an additional 375,000 options were issued, all of which vested immediately.

Table of Contents

Ampio has computed the fair value of all options granted using the Black-Scholes option pricing model. In order to calculate the fair value of the options, certain assumptions are made regarding components of the model, including the estimated fair value of the underlying common stock, risk-free interest rate, volatility, expected dividend yield, and expected option life. Changes to the assumptions could cause significant adjustments to valuation. Ampio estimated a volatility factor utilizing a weighted average of comparable published volatilities of peer companies. Due to the small number option holders, Ampio has estimated a forfeiture rate of zero. Ampio estimates the expected term based on the average of the vesting term and the contractual term of the options. The risk free interest rate is based on the U.S. Treasury yield in effect at the time of the grant for treasury securities of similar maturity. Accordingly, Ampio has computed the fair value of all options granted during the three months ended March 31, 2011 using the following assumptions:

Expected volatility	73%
Risk free interest rate	2.24%
Expected term (years)	5
Dividend yield	0%

Stock option activity is as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
Outstanding at December 31, 2010	2,930,000	$ 1.13	
Granted	375,000	$ 2.47	
Exercised	(25,000)	$ 1.03	
Issued in connection with BioSciences merger	212,693	$ 2.24	
Outstanding at March 31, 2011	3,492,693	$ 1.34	6.69
Exercisable at March 31, 2011	2,382,693	$ 1.49	6.69

The weighted average grant date fair value of options was $1.34. Ampio recognized stock-based compensation expense of $760,291 related to stock options during the three months ended March 31, 2011 and $2,057,374 from Inception to March 31, 2011. As of March 31, 2011, Ampio had $488,865 of unrecognized compensation costs from options granted under the plan to be recognized over a weighted average remaining period of 1.37 years.

Warrants

The 250,944 warrants issued in connection with the common stock financing were valued at $422,657 using the Black-Scholes option pricing model. In order to calculate the fair value of the warrants, certain assumptions were made regarding components of the model, including the closing price of the underlying common stock, risk-free interest rate, volatility, expected dividend yield, and expected life. Changes to the assumptions could cause significant adjustments to valuation. Since the expected life of five years was significantly longer than Ampio s stock trading history, Ampio estimated a volatility factor utilizing a weighted average of comparable published volatilities of peer companies. The risk-free interest rate is based on the U.S. Treasury yield in effect at the time of the grant for treasury securities of similar maturity.

The offering costs and the additional paid-in capital for the warrants associated with the common stock offering was valued using the Black-Scholes valuation methodology because that model embodies all of the relevant assumptions that address the features underlying these instruments. Significant assumptions were as follows as of the warrant inception date (March 31, 2011):

Exercise price	$ 1.75
Volatility	73%

Equivalent term (years)	5.00
Risk-free interest rate	2.24%

Table of Contents

Ampio issued warrants in 2011 in conjunction with its Redeemable Debentures and with the Private Placement as follows:

	Number of Warrants	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
Outstanding December 31, 2010	206,973	$ 1.750	
Warrants issued to Debenture holders	49,416	$ 1.750	
Warrants issued in connection with Private Placement	250,944	$ 3.125	
Outstanding March 31, 2011	507,333	$ 2.430	3.87

The exercise price of the warrants associated with Related Party Debentures and the Redeemable Debentures was fixed at $1.75 per share. The warrants expire on December 31, 2013.

The Warrants issued to Debenture holders in the three months ended March 31, 2011 were associated with the $382,000 January 2011 tranche of Redeemable Debentures and in conjunction with accrued interest.

The Warrants issued in connection with Private Placement were part of the offering costs associated with the sale of Common Stock in the three months ended March 31, 2011 and were issued with a $3.125 exercise price.

Note 9 Stock-Based Compensation

Stock-based compensation related to common stock issued to third party vendors in exchange for services was included in general and administrative expenses in the statement of operations as set forth in the table below. The common stock was recorded at its fair value at the dates Ampio became obligated to issue the shares, and is recognized as expense as the services are provided. Stock-based compensation expense related to the fair value of stock options was included in the statement of operations as research and development expenses and general and administrative expenses as set forth in the table below. Ampio determined the fair value as of the date of grant using the Black-Scholes option pricing method and expenses the fair value ratably over the vesting period.

The following table summarizes stock-based compensation expense for the three months ended March 31, 2011 and 2010:

	2011	2010
Research and development expenses		
Stock options	$ 57,000	$
General and administrative expenses		
Common stock issued for services	30,000	650,000
Stock options	703,000	
	$ 790,000	$ 650,000

Note 10 Related Party Transactions

In April 2009, Life Sciences (Ampio) issued 3,500,000 shares of its common stock to BioSciences, in connection with Life Sciences purchase of certain of BioSciences assets. Under the terms of the agreement, Life Sciences acquired office and lab equipment, cell lines and intellectual property including patents and license agreements. In conjunction with the asset purchase, Life Sciences recorded a distribution of $252,015 to reflect liabilities assumed. Included in the assumed liabilities was a $200,000 note payable to Life Sciences founder, Michael Macaluso. The 3,500,000 shares of Life Sciences (Ampio) common stock were surrendered to Ampio by BioSciences in connection with the BioSciences merger.

As of December 31, 2009, Life Sciences had $100,000 in notes payable to Mike Macaluso, Life Sciences founder, and $100,000 payable to BioSciences. The related party notes payable are unsecured, bear interest at 6% and initially were to mature on April 30, 2010. These notes were extended through September 2, 2010, and additional borrowings of $200,000 were made by Ampio from BioSciences in the three months ended June 30, 2010, bringing the total amount owed by Ampio to BioSciences to $300,000. The note evidencing the foregoing borrowing from Mr. Macaluso was paid in conjunction with the closing of the private placement on March 31, 2011 as discussed in Note 8 - Private Placement Offering. The $300,000 owed to BioSciences was eliminated with the merger in the three months ended March 31, 2011.

In October and November 2010, Ampio borrowed $215,971 from BioSciences in non interest bearing advances. As of December 31, 2010, non-interest bearing advances from BioSciences totaled $193,821. This amount was eliminated with the merger in the three months ended March 31, 2011.

Ampio has license agreements with the Institute for Molecular Medicine, Inc. a nonprofit research organization founded by Dr. Bar-Or, who also serves as its executive director. The license agreements were assigned to Life Sciences as a part of the asset purchase from BioSciences. Under the license agreements, Ampio pays the costs associated with maintaining intellectual property subject to the license agreements. In return, Ampio is entitled to deduct twice the amounts it has paid to maintain the intellectual property from any amounts that may become due to the Institute for Molecular Medicine, Inc. under the license agreements, if and when the intellectual property becomes commercially viable and generates revenue. Ampio may cease funding the intellectual property costs and abandon the license agreements at any time. Ampio incurred $42,901 during the three months ended March 31, 2011 and $9,554 in the three months ended March 31, 2010 in legal and patent fees to maintain the intellectual property of the Institute for Molecular Medicine, Inc.

Immediately prior to the merger, Chay accepted subscriptions for an aggregate of 1,325,000 share of common stock from six officers and employees of Life Sciences, for a purchase price of $150,183. These shares were issued immediately before the closing of the Chay merger but after the shareholders of Chay had approved the merger. The advances are non-interest bearing and due on demand and are classified as a reduction to stockholders equity.

Note 11 Subsequent Events

In addition to the private placement round closed on March 31, 2011 as discussed in Note 8- Common Stock, Ampio closed two additional rounds of April 8 and April 18, 2011 for total gross proceeds, including the March 31, 2011 closing, of $12,732,200 from sale of 5,092,880 shares of common stock. Commissions and non-accountable expenses to the placement agent were $1,400,542 and with total estimated additional offering costs, Ampio received net proceeds of approximately $10,900,000. In addition, Ampio issued 258,344 additional placement agent warrants which are exercisable for a period through March 31, 2016 at an exercise price of $3.125.

On April 23, 2011, the Ampio Board of Directors approved the acceleration of vesting of the remaining one-third of the 7,350,000 restricted common stock shares pursuant to the achievement of defined milestones.

Subsequent to March 31, 2011, under the terms of an employment agreement with the Chief Financial Officer, Ampio agreed to issue options to purchase 100,000 shares of common stock at an exercise price of $2.50 per share, half of which vest immediately with the remaining vesting in one year.

On May 5, 2011 an option holder in BioSciences and Ampio met and reached a tentative verbal understanding under which Ampio will issue, upon execution of a written settlement agreement, 263,000 options to three option holders in exchange for 98,416 shares of Ampio common stock that were issued to the option holders pursuant to the terms of the merger agreement. (See Note 3) The parties have now exchanged forms of written settlement agreements, but significant differences remain between such forms. Accordingly, there can be no assurance that the prior verbal understanding will be reduced to writing. If no written agreement is executed, the Company believes that litigation with the three option holder is likely. While the outcome of any such litigation is currently not ascertainable, the Company believes it has meritorious defenses to potential claims by the option holders and will defend itself vigorously. The Company believes that neither this dispute, nor its ultimate outcome, will have any material adverse effect on its business.

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

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion should be read in conjunction with Ampio Pharmaceutical Inc. s historical financial statements filed with this report. The following discussion and analysis contain forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those projected in the forward-looking statements. For additional information regarding these risks and uncertainties, please see Part II, Item 1A of this Form 10-Q, Risk Factors, and the risk factors included in Ampio s Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 16, 2011.

Background

We are a development stage company engaged in developing innovative, proprietary pharmaceutical drugs and diagnostic products to identify, treat and prevent a broad range of human diseases including metabolic disorders, eye disease, kidney disease, acute and chronic inflammation diseases and male sexual dysfunction. We intend to develop proprietary pharmaceutical drugs and diagnostic products which capitalize on our intellectual property that includes assigned patents, pending patent applications, and trade secrets and know-how, some of which may be the subject of future patent applications. Our intellectual property is strategically focused on three primary areas: new uses for FDA-approved drugs, referred to as repositioned drugs, new molecular entities, or NMEs, and rapid point-of-care tests for diagnosis, monitoring and screening.

Our predecessor, DMI Life Sciences, Inc., or Life Sciences, was incorporated in Delaware in December 2008 and did not conduct any business activity until April 16, 2009, at which time Life Sciences purchased certain assigned intellectual property (including 107 patents and pending patent applications), business products and tangible property from BioSciences. Life Sciences issued 3,500,000 shares of its common stock to BioSciences, and assumed certain liabilities, as consideration for the assets purchased from BioSciences. The assets Life Sciences acquired from BioSciences had a carrying value of zero, as BioSciences had expensed all of the research and development costs it incurred with respect to the intellectual property purchased by Life Sciences.

In March 2010, Life Sciences was merged with a subsidiary of Chay Enterprises, Inc., a publicly-traded company then traded on the OTC Bulletin Board. Chay Enterprises had minimal operations prior to the time of this merger, and like similar entities was referred to as a public shell. As a result of this merger, Life Sciences shareholders became the controlling shareholders of Chay Enterprises and the former sole officer and director of Chay Enterprises appointed a majority of our current management team to their present positions. We were reincorporated in Delaware at that time as Ampio Pharmaceuticals, Inc. and commenced trading on the OTC Bulletin Board as Ampio Pharmaceuticals, Inc. in late March 2010.

Recent Developments

On March 23, 2011, we closed the BioSciences acquisition, through which we obtained the rights to BioSciences sole product, Zertane, which treats male sexual dysfunction for premature ejaculation, or PE. We acquired BioSciences in exchange for 8,667,905 shares of Ampio common stock, or the merger stock. The business combination occurred following the satisfaction or waiver of all conditions to closing. As called for in the merger agreement, we issued 405,066 shares of merger stock to holders of BioSciences in-the-money stock options and warrants, 500,000 shares of merger stock to holders of two BioSciences promissory notes in extinguishment of the notes, and placed 250,000 shares of merger stock in an indemnification escrow until December 31, 2011. The remaining 7,512,839 shares of merger stock were issued to the holders of BioSciences common stock pro rata, subject to receipt from each such stockholder of a signed lock-up agreement under which each agreed, or will agree, not to sell, pledge or hypothecate the merger stock until on or after December 31, 2011 or, in the case of executive officers or directors of BioSciences and executive officers of Ampio, until February 29, 2012. As required by the merger agreement, at the closing BioSciences donated back to our capital 3,500,000 shares of our common stock formerly owned by BioSciences. We separately issued 212,693 options in replacement of 250,850 Biosciences options that were out-of-the-money as of the date of execution of the merger agreement. As required by the Merger Agreement, BioSciences donated back to the capital of Ampio at the effective time an aggregate of 3,500,000 shares of Ampio common stock formerly owned by BioSciences.

On February 28, 2011, we issued an aggregate of 1,281,852 shares of our common stock in retirement of the convertible debentures issued to 21 holders of such debentures. The convertible debentures were issued in three tranches. The first tranche consisted of $430,000 in principal amount issued in August 2010 to two directors and an affiliate of one of those directors. The second tranche consisted of $1.38 million in principal amount issued in November 2010 to 19 unaffiliated holders (seven of whom were already our shareholders), and the third tranche in January 2011 was an increase of $382,000 in principal amount of debentures purchased by five holders who originally purchased debentures in November 2010. The principal amount of the debentures and

21

accrued interest were converted into our common stock at $1.75 per share. Debentures held by two directors and an affiliate of one director were converted on the same terms as debentures held by unaffiliated parties. The debenture holders were collectively issued warrants to purchase 256,389 shares of our common stock as additional consideration for the purchase of the debentures. Those warrants are exercisable at $1.75 per share.

We closed the sale of an aggregate of 5,092,880 shares of our common stock in private placements at three closings in March and April, 2011. We received net proceeds of $10.9 million after placement agent commissions, a non-accountable expense allowance, and other offering expenses. We expect these net proceeds will be sufficient to fund our current operations into the fourth quarter of 2012. We currently intend to use the net proceeds to fund preliminary commercialization efforts related to Zertane, to fund clinical trials for Optina and Ampion, to fund sponsored research on our behalf by Trauma Research, LLC, a related party (TRLLC), to maintain and obtain intellectual property protection, and for general and administrative expenses. We applied a portion of the placement proceeds in March and April 2011 to pay accrued expenses, to pay accrued salaries owed to certain of our officers, to reduce accounts payable, and to repay a $100,000 promissory note to Michael Macaluso, our chairman of the board. Pending our use of the placement proceeds, we have invested such proceeds in short-term money market funds.

Known Trends or Future Events

We have not generated any revenues and have therefore incurred significant net losses since our inception in December 2008. The assets we purchased from BioSciences in April 2009 did generate minimal revenues prior to their acquisition. Unless we secure a collaborator for one or more of our product candidates and generate license revenues, we will need additional capital in order to continue to implement our business strategy. Although we have raised capital in the past and raised net proceeds of $10.9 million through the sale of common stock in March and April of 2011, we cannot assure you that we will secure such additional financing, if needed, or that it will be adequate to execute our business strategy. Even if we obtain additional financing, it may be costly and may require us to agree to covenants or other provisions that will favor new investors over existing shareholders. Due to the time required to conduct clinical trials and obtain regulatory approval for any of our product candidates, we anticipate it will be some time before we generate substantial revenues, if ever. We expect to generate operating losses for the foreseeable future, but intend to limit the extent of these losses by entering into co-development or collaboration agreements with one or more strategic partners. We do not currently have any such agreements in effect.

Results of Operations March 31, 2011 Compared to March 31, 2010

Results of operations for the three months ended March 31, 2011 (the 2011 period) and the three months ended March 31, 2010 (the 2010 period) reflected losses of $8,779,000 and $1,482,000, respectively.

Revenue

We are a development stage enterprise and have not generated material revenue in our operating history

Table of Contents

Expenses

Research and Development

Research and development costs are summarized as follows:

	Three Months Ended March 31, 2011	2010
Stock-based compensation	57,000	
Patent costs	131,000	65,000
Labor	225,000	207,000
Clinical trials and sponsored research	211,000	
Consultants	9,000	30,000
All other		36,000
	$ 633,000	$ 338,000

The $295,000, or 87.3%, increase in expenses from the 2010 period to the 2011 period resulted primarily from the increase in clinical trials and sponsored research, which comprised 71.5% of the overall increase in such costs from the 2010 period to the 2011 period.

General and Administrative

General and administrative costs are summarized as follows:

	Three Months Ended March 31, 2011	2010
Stock-based compensation	$ 733,000	$ 650,000
Directors fees	96,000	
Professional fees	347,000	291,000
Labor	289,000	135,000
Occupancy, travel and other	139,000	65,000
	$ 1,604,000	$ 1,141,000

General and administrative expenses increased by $463,000, or 40.6%, from the 2010 period to the 2011 period. That rise represented across-the-board increases in all categories of general and administrative costs, as we significantly expanded our operations on a period to period basis. A portion of the increase in professional fees was attributable to costs associated with the BioSciences merger, which was concluded in the 2011 period. . The increase in directors fees results from our adoption of a compensation plan in August, 2010 for our outside directors.

Derivative expense

We recorded $948,000 in derivative expense in the 2011 period in connection with our debentures and related warrants. We had no derivatives outstanding in the 2010 period. The expense relates to the fair value at inception of hybrid financial instruments (debentures and warrants) issued in 2011 stemming from the embedded derivative features (conversion options, down-round protection and mandatory conversion provisions) and the changes in fair value of warrants during the first quarter of 2011.

Unrealized loss on fair value of debt instruments

We recorded $5,585,000 in unrealized loss on fair value of debt instruments. The expense reflects the change in fair value of our debentures prior to their conversion to common stock in February, 2011 and stemmed primarily from the increase in our common stock price between December 31, 2010 and February 21, 2011.

Net Cash Used in Operating Activities

During the 2011 period, our operating activities used $1,786,000 in cash. The use of cash reflected an $8,779,000 net loss, non-cash charges of $790,000 for common stock issued for services and stock based compensation, and non-cash charges of $6,534,000 for derivative expense and unrealized loss on fair value of financial instruments. Net of these non-cash expenses, our operations used $1,455,000 in cash. We also used $331,000 in cash from operations to pay deferred salaries, accounts payable, related party payables and net changes in other current assets.

Net Cash from Financing Activities

Net cash provided by our financing activities was $5,674,000 in the 2011 period. During this period, we received $382,000 from the sale of additional senior unsecured debentures and $5,392,000 from the sale of common stock. We also repaid a $100,000 note to a director.

Liquidity and Capital Resources

Since the 2010 period, we have funded our operations primarily through sales of our equity and debt securities. We had $4,559,000 in cash on hand at March 31, 2011, reflecting the first closing of the placement which occurred on that date. In addition, we received proceeds from the sales of common stock of $5.4 million from the sale of common stock in April 2011. We expect our cash reserves to last into the fourth quarter of 2012 based on our currently planned level of operations. In order to continue to execute on our business plan, it will be necessary to raise additional capital and/or enter into licensing or collaboration agreements. We cannot provide assurance that we will be able to raise capital or enter into licensing or collaboration agreements. Until we secure any licensing or collaboration agreements, we expect to satisfy our future cash needs through private or public sales of our securities or debt financings. We cannot be certain that funding will be available to us on acceptable terms, or at all. Over the last two years, volatility in the financial markets has adversely affected the market capitalizations of many pharmaceutical companies and generally made equity and debt financing more difficult to obtain. This volatility, coupled with other factors, may limit our access to additional financing.

If we cannot raise adequate additional capital in the future when we require it, we will be required to delay, reduce the scope of, or eliminate one or more of our research or development programs or our commercialization efforts. We also may be required to relinquish greater or all rights to product candidates at an earlier stage of development or on less favorable terms than we would otherwise choose. This may lead to impairment or other charges, which could materially affect our balance sheet and operating results.

Off Balance Sheet Arrangements

We do not have off-balance sheet arrangements, financings, or other relationships with unconsolidated entities or other persons, also known as variable interest entities.

Recently Issued Accounting Pronouncements

Ampio has reviewed the accounting pronouncements up through Update No. 2011-03 and does not expect any of these updates to have a material impact on its financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The Company is not currently exposed to material market risk arising from financial instruments, changes in interest rates or commodity prices, or fluctuations in foreign currencies. The Company has no need to hedge against any of the foregoing risks and therefore currently engages in no hedging activities.

Item 4T. Controls and Procedures.

As previously noted in our 2010 Form 10-K filed on February 16, 2010, in Item 9A, Controls and Procedures - Management s Annual Report on Internal Control over Financial Reporting, our internal control over financial reporting was not effective due to material weaknesses in the system of internal control. However, we concluded that the material weaknesses did not result in deficient financial reporting. As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was carried out by the Company s management, with the participation of the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company s disclosure controls and procedures, as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures are sufficient to ensure that information required to be disclosed in the reports the Company files or furnishes under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and regulations, and are operating in an effective manner.

An evaluation was also performed under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of any change in our internal control over financial reporting that occurred during the 2011 period and that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. While we believe our internal accounting controls over financial reporting were adequate, in order to further improve and enhance internal accounting controls over financial reporting and ultimately comply with applicable Sarbanes-Oxley requirements, the Company engaged a controller in January, 2011 and a Chief Financial Officer in early April, 2011 who is a Certified Public Accountant.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

The Company is currently not party to any material pending legal proceedings, whether routine or non-routine.

On January 25, 2011, Ampio received an email from an option holder of BioSciences, in which he informed Ampio that the issuance of Ampio common stock in extinguishment of his BioSciences options may result in adverse tax consequences to him. The email included an unspecified statement of intent to litigate the issue. Ampio believes the issuance of Ampio common stock in extinguishment of the BioSciences options was a specific objective supported by the BioSciences board of directors in negotiating the merger agreement, as amended. Thereafter, the option holder asserted different bases upon which he believed he was treated inequitably by having his BioSciences options extinguished in exchange for Ampio common stock, and reiterated his intent to litigate this issue. The Company is informed that two additional option holders concurred in the position taken by this option holder.

On May 5, 2011 the option holder and Ampio met and reached a tentative verbal understanding under which Ampio will issue, upon execution of a written settlement agreement, 263,000 options to the three option holders in exchange for the 98,416 shares of Ampio common stock that were issued to the option holders pursuant to the terms of the merger agreement. The parties have now exchanged forms of written settlement agreements, but significant differences remain between such forms. Accordingly, there can be no assurance that the prior verbal understanding will be reduced to writing. If no written agreement is executed, the Company believes that litigation with the three option holders is likely. While the outcome of any such litigation is currently not ascertainable, the Company believes it has meritorious defenses to potential claims by the option holders and will defend itself vigorously. The Company believes that neither this dispute, nor its ultimate outcome, will have any material adverse effect on its business.

Item 1A. Risk Factors.

Certain factors exist which may affect the Company s business and could cause actual results to differ materially from those expressed in any forward-looking statements. The Company has not experienced any material changes from those risk factors as previously disclosed in the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on April 19, 2011 (the S-1). However, the Company continues to require additional capital, the receipt of which is not assured. We incorporate by reference the risk factors included in the S-1, SEC File No. 333-173589.

Item 2. Unregistered Sales of Securities and Use of Proceeds.

The Company previously furnished the information required by Item 701 of Regulation S-K in the Form 8-K filed with the SEC on April 19, 2011 (the Form 8-K). The Company incorporates by reference herein the information included in Item 3.02 of the Form 8-K.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. [Removed and Reserved].

Item 5. Other Information.

None.

Item 6. Exhibits

Exhibit Number	Description
31.1	Certificate of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certificate of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

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

AMPIO PHARMACEUTICALS, INC.

By: /s/ DONALD B. WINGERTER, JR.
Donald B. Wingerter, Jr.

Chief Executive Officer

Date: May 13, 2011

By: /s/ Mark D. McGregor
Mark D. McGregor

Chief Financial Officer

Date: May 13, 2011

26