NewStar Financial, Inc.
Form 10-Q
May 03, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2012

OR

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

For the transition period from ______ to ______

Commission File Number 001-33211

NewStar Financial, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**54-2157878**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
500 Boylston Street, Suite 1250,	
Boston, MA	**02116**
(Address of principal executive offices)	**(Zip Code)**

(617) 848-2500

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

As of April 27, 2012, 49,254,997 shares of common stock, par value of $0.01 per share, were outstanding.

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Note Regarding Forward Looking Statements

This Quarterly Report on Form 10-Q of NewStar Financial, Inc., contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These are statements that relate to future periods and include statements about:

- our anticipated financial condition, including estimated loan losses;
- our expected results of operation;
- our ability to meet draw requests under commitments to borrowers under certain conditions;
- our growth and market opportunities;
- trends and conditions in the financial markets in which we operate;
- our future funding needs and sources and availability of funding;
- our involvement in capital-raising transactions;
- our competitors;
- our provision for credit losses;
- our future development of our products and markets;
- our ability to compete; and
- our stock price.

Generally, the words anticipates, believes, expects, intends, estimates, projects, plans and similar expressions identify forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause our actual results, performance, achievements or industry results to differ materially from any future results, performance or achievements expressed or implied by these forward-looking statements. These risks, uncertainties and other important factors include, among others:

- acceleration of deterioration in credit quality that could result in levels of delinquent or non-accrual loans that would force us to realize credit losses exceeding our allowance for credit losses and deplete our cash position;

- risks and uncertainties relating to the financial markets generally, including disruptions in the global financial markets;
- our ability to obtain external financing;
- the regulation of the commercial lending industry by federal, state and local governments;
- risks and uncertainties relating to our limited operating history;
- our ability to minimize losses, achieve profitability, and realize our deferred tax asset; and
- the competitive nature of the commercial lending industry and our ability to effectively compete.

For a further description of these and other risks and uncertainties, we encourage you to carefully read section Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2011.

The forward-looking statements contained in this Quarterly Report on Form 10-Q speak only as of the date of this report. We expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement contained in this Quarterly Report to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any forward-looking statement is based, except as may be required by law.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

NEWSTAR FINANCIAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2012 (unaudited)	December 31, 2011
	($ in thousands, except share and par value amounts)	
Assets:		
Cash and cash equivalents	$ 17,390	$ 18,468
Restricted cash	104,951	83,815
Investments in debt securities, available-for-sale	19,038	17,817
Loans held-for-sale, net	37,945	38,278
Loans, net	1,773,306	1,699,187
Deferred financing costs, net	13,880	11,997
Interest receivable	9,057	9,857
Property and equipment, net	715	740
Deferred income taxes, net	48,016	47,902
Income tax receivable	0	293
Other assets	23,653	18,029
Total assets	$ 2,047,951	$ 1,946,383
Liabilities:		
Credit facilities	$ 319,652	$ 214,711
Term debt	1,070,052	1,073,105
Repurchase agreements	62,687	64,868
Accrued interest payable	2,965	2,853
Accounts payable	379	430
Income tax payable	1,372	0
Other liabilities	20,249	26,654
Total liabilities	1,477,356	1,382,621
Stockholders equity:		
Preferred stock, par value $0.01 per share (5,000,000 shares authorized; no shares outstanding)	0	0
Common stock, par value $0.01 per share:		
Shares authorized: 145,000,000 in 2012 and 2011;		
Shares outstanding 49,315,740 in 2012 and 49,345,676 in 2011	493	494
Additional paid-in capital	637,280	635,389
Accumulated deficit	(38,621)	(44,703)
Common stock held in treasury, at cost $0.01 par value; 3,320,627 in 2012 and 3,135,317 in 2011	(27,288)	(25,420)
Accumulated other comprehensive loss, net	(1,269)	(1,998)
Total stockholders equity	570,595	563,762
Total liabilities and stockholders equity	$ 2,047,951	$ 1,946,383

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NEWSTAR FINANCIAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

Unaudited

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
	($ in thousands, except per share amounts)	
Net interest income:		
Interest income	$ 29,522	$ 26,988
Interest expense	8,353	8,542
Net interest income	21,169	18,446
Provision for credit losses	2,881	6,253
Net interest income after provision for credit losses	18,288	12,193
Non-interest income:		
Fee income	1,255	575
Asset management income related party	743	628
Loss on derivatives	(15)	(4)
Loss on sale of loans	(450)	0
Other income (loss)	1,252	(1,680)
Total non-interest income (loss)	2,785	(481)
Operating expenses:		
Compensation and benefits	7,202	7,545
General and administrative expenses	3,493	2,604
Total operating expenses	10,695	10,149
Income before income taxes	10,378	1,563
Income tax expense	4,296	637
Net income	$ 6,082	$ 926
Basic income per share	$ 0.13	$ 0.02
Diluted income per share	0.12	0.02

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NEWSTAR FINANCIAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Unaudited

	Three Months Ended March 31, 2012	2011
	($ in thousands)	
Net Income	$ 6,082	$ 926
Net unrealized securities gains, net of tax expense of $473 and $181, respectively	692	29
Net unrealized derivative gains, net of tax expense (benefit) of $38 and (180), respectively	37	278
Comprehensive income	$ 6,811	$ 1,233

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NEWSTAR FINANCIAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

Unaudited

	NewStar Financial, Inc. Stockholders Equity					
	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Loss, net	Common Stockholders Equity
	($ in thousands)					
Balance at January 1, 2012	$ 494	$ 635,389	$ (44,703)	$ (25,420)	$ (1,998)	$ 563,762
Net income	0	0	6,082	0	0	6,082
Other comprehensive income	0	0	0	0	729	729
Issuance of restricted stock	1	(1)	0	0	0	0
Net shares reacquired from employee transactions	0	0	0	(37)	0	(37)
Tax benefit from vesting of restricted common stock awards	0	(6)	0	0	0	(6)
Repurchase of common stock	(2)	2	0	(1,831)	0	(1,831)
Amortization of restricted common stock awards	0	1,473	0	0	0	1,473
Amortization of stock option awards	0	423	0	0	0	423
Balance at March 31, 2012	$ 493	$ 637,280	$ (38,621)	$ (27,288)	$ (1,269)	$ 570,595

	NewStar Financial, Inc. Stockholders Equity					
	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Loss, net	Common Stockholders Equity
Balance at January 1, 2011	$ 506	$ 626,177	$ (58,851)	$ (13,115)	$ (538)	$ 554,179
Net income	0	0	926	0	0	926
Other comprehensive income	0	0	0	0	307	307
Net shares reacquired from employee transactions	(1)	112	0	(988)	0	(877)
Tax benefit from vesting of restricted common stock awards	0	778	0	0	0	778
Amortization of restricted common stock awards	0	1,620	0	0	0	1,620
Amortization of stock option awards	0	848	0	0	0	848
Balance at March 31, 2011	$ 505	$ 629,535	$ (57,925)	$ (14,103)	$ (231)	$ 557,781

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NEWSTAR FINANCIAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

	Three Months Ended March 31, 2012	2011
	($ in thousands)	
Cash flows from operating activities:		
Net income	$ 6,082	$ 926
Adjustments to reconcile net income (loss) to net cash used for operations:		
Provision for credit losses	2,881	6,253
Depreciation and amortization and accretion	(1,784)	(2,747)
Amortization of debt issuance costs	1,024	2,023
Equity compensation expense	1,896	2,468
Loss on sale of loans	450	0
Gain on repurchase of debt	(946)	(1,015)
Losses from equity method investments	203	3,406
Net change in deferred income taxes	(113)	(44)
Loans held-for-sale originated	(32,721)	(19,090)
Proceeds from sale of loans held-for-sale	33,054	41,386
Net change in interest receivable	800	(653)
Net change in other assets	(5,568)	14,297
Net change in accrued interest payable	112	(336)
Net change in accounts payable and other liabilities	(5,635)	(10,846)
Net cash provided by (used in) operating activities	(265)	36,028
Cash flows from investing activities:		
Net change in restricted cash	(21,136)	87,437
Net change in loans	(75,547)	(7,652)
Proceeds from repayments of debt securities available-for-sale	0	76
Acquisition of property and equipment	(110)	(265)
Net cash provided by (used in) investing activities	(96,793)	79,596
Cash flows from financing activities:		
Proceeds from exercise of stock options	108	105
Tax benefit (expense) from vesting of restricted stock	(6)	778
Borrowings on credit facilities	163,242	58,204
Repayment of borrowings on credit facilities	(58,301)	(88,361)
Borrowings on term debt	74,900	17,016
Repayment of borrowings on term debt	(77,007)	(120,290)
Repayment of borrowings on repurchase agreements	(2,181)	0
Payment of deferred financing costs	(2,907)	(291)
Purchase of treasury stock	(1,868)	(988)
Net cash provided by (used in) financing activities	95,980	(133,827)
Net decrease in cash during the period	(1,078)	(18,203)
Cash and cash equivalents at beginning of period	18,468	54,365
Cash and cash equivalents at end of period	$ 17,390	$ 36,162

Supplemental cash flows information:		
Interest paid	$ 8,241	$ 8,878
Taxes paid	3,262	1,225
Increase in fair value of investments in debt securities	(1,165)	(110)
Transfer of asset to OREO	9,400	0

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NEWSTAR FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

Note 1. Organization

NewStar Financial, Inc. (the Company), a Delaware corporation, is a specialized commercial finance company focused on meeting the complex financing needs of companies and private investors in the middle market. The Company focuses primarily on the direct origination of bank loans and equipment leases through teams of credit-trained bankers and marketing officers organized around key industry and market segments. The Company s marketing and direct origination efforts target private equity sponsors, mid-sized companies, corporate executives, regional banks, real estate investors and a variety of other referral sources and financial intermediaries to source new customer relationships and lending opportunities. The Company s emphasis on direct origination is an important aspect of its marketing and credit strategy because it provides direct access to customers management teams and enhances the Company s ability to conduct detailed due diligence and credit analysis of prospective borrowers. It also allows the Company to negotiate transaction terms directly with borrowers and, as a result, it has significant input into customers financial strategies and capital structures. From time to time, the Company also participates in loans as a member of a lending group. The Company employs highly experienced bankers, marketing officers and credit professionals to identify and structure new lending opportunities and manage customer relationships. The Company believes that the quality of its professionals, the breadth of their relationships and referral networks, and their ability to develop creative solutions for customers position it to be a valued partner and preferred lender for mid-sized companies.

The Company operates as a single segment, and it derives revenues from four specialized lending groups that target market segments in which it believes that it has a competitive advantage:

Leveraged Finance, provides senior, secured cash flow loans and, to a lesser extent, second lien, and subordinated debt, and equity or other equity-linked products, which are primarily used to finance acquisitions of mid-sized companies with annual cash flow (EBITDA) typically between $5 million and $30 million by private equity investment funds managed by established professional alternative asset managers;

Real Estate, provides first mortgage debt and, to a lesser extent, subordinated debt, primarily to finance acquisitions of commercial real estate properties typically valued between $10 million and $50 million by professional commercial real estate investors;

Business Credit, provides senior, secured asset-based loans primarily to fund working capital needs of mid-sized companies with sales typically totaling between $25 million and $500 million; and

Equipment Finance, provides leases, loans and lease lines to finance equipment purchases and other capital expenditures typically for companies with annual sales of at least $25 million.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

These interim condensed consolidated financial statements include the accounts of the Company and its subsidiaries (collectively, NewStar) and have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). All significant intercompany transactions have been eliminated in consolidation. These interim condensed financial statements include adjustments of a normal and recurring nature considered necessary by management to fairly present NewStar s financial position, results of operations and cash flows. These interim condensed financial statements may not be indicative of financial results for the full year. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosure of contingent assets and liabilities. Actual results could differ from those estimates. The estimates most susceptible to change in the near-term are the Company s estimates of its (i) allowance for credit losses, (ii) recorded amounts of deferred income taxes, (iii) fair value measurements used to record fair value adjustments to certain financial instruments, (iv) valuation of investments and (v) determination of other than temporary impairments and temporary impairments. The interim condensed consolidated financial statements and notes thereto should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

Recently Adopted Accounting Standards

In April 2011, the FASB issued ASU 2011-03, *Transfers and Servicings (Topic 860): Reconsideration of Effective Control for Repurchase Agreements.* ASU 2011-03 changes the assessment of effective control by focusing on the transferor s contractual rights and obligations and removing the criterion to assess the ability to exercise those rights or honor those obligations. ASU 2011-03was effective for the interim or annual period beginning on or after December 15, 2011. The adoption of ASU 2011-03 did not have a material effect on the Company s results from operations or financial position.

In May 2011, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* ASU 2011-04 establishes common fair value measurement and disclosure requirements in GAAP and IFRS. ASU 2011-04 amends topic 820 by clarifying the intent of the application of existing fair value measurement and disclosure requirements. The amendments in this update also change the fair value measurement of financial instruments that are managed within a portfolio subject to market risks and the credit risk of counterparties, the application of premiums and discounts in a fair value measurement, and require additional fair value measurement disclosures. ASU 2011-04 will be applied prospectively and is effective during interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 did not have a material effect on the Company s results from operations or financial position.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*. ASU 2011-05 gives two options for presenting other comprehensive income (OCI). An OCI statement can be included with the net income statement, which together will make a statement of total comprehensive income. Alternatively an OCI statement may be presented separately from a net income statement, but the two statements must appear consecutively within a financial report. Currently, ASU 2011-05 is being applied retrospectively and is effective for fiscal years and interim periods within those years, beginning after December 15, 2011. In October 2011, the FASB announced that it is considering deferring certain provisions in ASU 2011-05 related to the presentation and reclassification adjustments from other comprehensive income to net income. The adoption of ASU 2011-05 did not have an impact on the Company s results of operations or financial position as it only impacts required disclosures.

Prior Period Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation. Occupancy and equipment are now included in General and administrative expenses.

Note 3. Loans Held-for-Sale, Loans and Allowance for Credit Losses

The Company operates as a single segment, and derives revenues from four specialized lending groups that target market segments in which it believes it has a competitive advantage:

Leveraged Finance, provides senior, secured cash flow loans and, to a lesser extent, second lien, and subordinated debt, and equity or other equity-linked products, which are primarily used to finance acquisitions of mid-sized companies by private equity investment funds managed by established professional alternative asset managers;

Real Estate, provides first mortgage debt and, to a lesser extent, subordinated debt, primarily to finance acquisitions of commercial real estate properties;

Business Credit, provides senior, secured asset-based loans primarily to fund working capital needs of mid-sized companies; and

Equipment Finance, provides leases, loans and lease lines to finance equipment purchases and other capital expenditures.

The Company s loan portfolio consists primarily of loans to small and medium-sized, privately-owned companies, most of which do not publicly report their financial condition. Compared to larger, publicly traded firms, loans to these types of companies may carry higher inherent risk. The companies that the Company lends to generally have more limited access to capital and higher funding costs, may be in a weaker financial position, may need more capital to expand or compete, and may be unable to obtain financing from public capital markets or from traditional sources, such as commercial banks

Borrowers within the Company s Leveraged Finance and Business Credit groups may be particularly susceptible to economic slowdowns or recessions and, as a result, may be unable to make scheduled payments of interest or principal on their borrowings during these periods. Adverse economic conditions also may decrease the estimated value of the collateral, particularly real estate, securing some of the Company s loans.

Loans classified as held-for-sale may consist of loans originated by the Company and intended to be sold or syndicated to third parties (including the NewStar Credit Opportunities Fund, Ltd. (NCOF), a related party) or impaired loans for which a sale of the loan is expected as a result of a workout strategy. At March 31, 2012 loans held-for-sale consisted of leveraged finance loans to six borrowers which are intended to be sold to the NCOF at an agreed upon price or to entities other than the NCOF. Subsequent to March 31, 2012, the Company sold loans with an aggregate outstanding balance of $8.4 million to the NCOF as intended.

These loans are carried at the lower of aggregate cost, net of any deferred origination costs or fees, or market value.

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As of March 31, 2012 and December 31, 2011, loans held-for-sale consisted of the following:

	March 31, 2012	December 31, 2011
	($ in thousands)	
Leveraged Finance	$ 38,317	$ 38,838
Gross loans	38,317	38,838
Deferred loan fees, net	(372)	(560)
Total loans, net	$ 37,945	$ 38,278

Loans held-for-sale consisted of loans the Company intended to sell to the NCOF as well as loans intended to be sold to entities other than the NCOF. The Company sold two loans with an aggregate outstanding balance of $9.7 million for a loss of $0.5 million to entities other than the NCOF during the three months ended March 31, 2012. The Company did not sell any loans to an entity other than the NCOF during the three months ended March 31, 2011.

As of March 31, 2012 and December 31, 2011, loans and leases consisted of the following:

	March 31, 2012	December 31, 2011
	($ in thousands)	
Leveraged Finance	$ 1,498,066	$ 1,437,040
Real Estate	222,684	271,381
Business Credit	150,829	111,772
Gross loans and leases	1,871,579	1,820,193
Deferred loan fees, net	(34,597)	(57,306)
Allowance for loan and lease losses	(63,676)	(63,700)
Total loans and leases, net	$ 1,773,306	$ 1,699,187

As of March 31, 2012 and December 31, 2011, Equipment Finance leases totaled $12.6 million and $3.7 million, respectively, and are included in the Business Credit balances above.

The Company grants commercial loans, commercial real estate loans, and leases to customers throughout the United States. Although the Company has a diversified loan and lease portfolio, certain events have occurred, including, but not limited to, adverse economic conditions and adverse events affecting specific clients, industries or markets, that may adversely affect the ability of borrowers to make timely scheduled principal and interest payments on their loans and leases.

The Company internally risk rates loans based on individual credit criteria on at least a quarterly basis. Borrowers provide the Company with financial information on either a quarterly or monthly basis. Loan ratings as well as identification of impaired loans are dynamically updated to reflect changes in borrower condition or profile. A loan is considered to be impaired when it is probable that the Company will be unable to collect all amounts due to it according to the contractual terms of the loan agreement. Impaired loans include all nonaccrual loans, loans with partial charge-offs and loans which are troubled debt restructurings (TDR).

The Company utilizes a number of analytical tools for the purpose of estimating probability of default and loss given default which vary between its four specialized lending groups. The quantitative models employed by the Company in its Leveraged Finance and Equipment Finance businesses utilize Moody s KMV RiskCalc credit risk model in combination with a proprietary qualitative model, which generates a rating that maps to a probability of default. Real Estate utilizes a proprietary model that has been developed to capture risk characteristics unique to the lending activities in that line of business. The model produces an obligor risk rating which corresponds to a probability of default and also produces a loss given default. In each case, the probability of default and the loss given default are used to calculate an expected loss for those lending groups. Due to the nature of its borrowers and the structure of its loans, Business Credit utilizes a proprietary model that produces a rating that corresponds to an expected loss, without calculating a probability of default and loss given default. In each case, the expected loss is the primary component in a formulaic calculation of general reserves attributable to a given loan.

Loans and leases which are rated at or below a specified threshold are typically classified as Pass , and loans and leases rated above that threshold are typically classified as Criticized , a characterization that would apply to impaired loans, including TDR. As of March 31, 2012, $243,8 million of the Company s loans were classified as Criticized , including $214.4 million of the Company s impaired loans, and $1.6 billion were classified as Pass . As of December 31, 2011, $300.9 million of the Company s loans were classified as Criticized , including $284.9 million of the Company s impaired loans, and $1.5 billion were classified as Pass .

When the Company rates a loan above a further threshold, the Company will establish a specific allowance, and the loan will be analyzed and may be placed on non-accrual. If the asset deteriorates further, the specific allowance may increase, and ultimately may result in a loss and charge-off.

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A TDR that performs in accordance with the terms of the restructuring may improve its risk profile over time. While the concessions in terms of pricing or amortization may not have been reversed and further amended to market levels, the financial condition of the Borrower may improve over time to the point where the rating improves from the Criticized classification that was appropriate immediately prior to, or at, restructuring.

As of March 31, 2012, the Company had impaired loans with an aggregate outstanding balance of $290.2 million. Impaired loans with an aggregate outstanding balance of $245.5 million have been restructured and classified as TDR. As of March 31, 2012, the aggregate carrying value of equity investments in certain of the Company s borrowers in connection with troubled debt restructurings totaled $7.0 million. Impaired loans with an aggregate outstanding balance of $77.1 million were also on non-accrual status. For impaired loans on non-accrual status, the Company s policy is to reverse the accrued interest previously recognized as interest income subsequent to the last cash receipt in the current year. The recognition of interest income on the loan only resumes when factors indicating doubtful collection no longer exist and the non-accrual loan has been brought current. During the three months ended March 31, 2012, the Company charged off $4.2 million of outstanding non-accrual loans and recovered $1.3 million of previously charged-off impaired loan outstanding balances. The Company did not take off nor place any loans on non-accrual status during the three months ended March 31, 2012. During the three months ended March 31, 2012, the Company recorded $1.6 million of specific provisions for impaired loans. At March 31, 2012, the Company had a $39.4 million specific allowance for impaired loans with an aggregate outstanding balance of $189.7 million. At March 31, 2012, additional funding commitments for impaired loans totaled $42.3 million. The Company s obligation to fulfill the additional funding commitments on impaired loans is generally contingent on the borrower s compliance with the terms of the credit agreement and the borrowing base availability for asset-based loans, or if the borrower is not in compliance additional funding commitments may be made at the Company s discretion. As of March 31, 2012, $49.4 million of loans on non-accrual status were greater than 60 days past due and classified as delinquent by the Company. Included in the $39.4 million specific allowance for impaired loans was $7.8 million related to delinquent loans.

As of December 31, 2011, the Company had impaired loans with an aggregate outstanding balance of $316.3 million. Impaired loans with an aggregate outstanding balance of $243.5 million have been restructured and classified as TDR. As a result of the adoption of ASU 2011-02, the Company classified loans with an outstanding balance of $15.5 million as TDR during 2011. As of December 31, 2011, the aggregate carrying value of equity investments in certain of the Company s borrowers in connection with troubled debt restructurings totaled $7.1 million. Impaired loans with an aggregate outstanding balance of $102.2 million were also on non-accrual status. For impaired loans on non-accrual status, the Company s policy is to reverse the accrued interest previously recognized as interest income subsequent to the last cash receipt in the current year. The recognition of interest income on the loan only resumes when factors indicating doubtful collection no longer exist and the non-accrual loan has been brought current. During 2011, the Company took previously identified non-accrual loans with an aggregate outstanding balance of $38.2 million as of December 31, 2010 off non-accrual status, placed loans with an aggregate balance of $56.4 million as of December 31, 2011 on non-accrual status and charged off $38.0 million of outstanding non-accrual loans. During 2011, the Company recorded $18.8 million of specific provisions for impaired loans. At December 31, 2011, the Company had a $40.7 million specific allowance for impaired loans with an aggregate outstanding balance of $208.4 million. At December 31, 2011, additional funding commitments for impaired loans totaled $46.3 million. The Company s obligation to fulfill the additional funding commitments on impaired loans is generally contingent on the borrower s compliance with the terms of the credit agreement and the borrowing base availability for asset-based loans, or if the borrower is not in compliance additional funding commitments may be made at the Company s discretion. As of December 31, 2011, $88.8 million of loans on non-accrual status and an additional $8.4 million of loans were greater than 60 days past due and classified as delinquent by the Company. Included in the $40.7 million specific allowance for impaired loans was $13.8 million related to delinquent loans.

A summary of impaired loans is as follows:

	Investment	Unpaid Principal	Recorded Investment with a Related Allowance for Credit Losses	Recorded Investment without a Related Allowance for Credit Losses
March 31, 2012			($ in thousands)	
Leveraged Finance	$ 224,581	$ 297,204	$ 142,930	$ 81,651
Real Estate	63,560	81,174	46,729	16,831
Business Credit	2,095	2,695		2,095
Total	$ 290,236	$ 381,073	$ 189,659	$ 100,577

December 31, 2011				
Leveraged Finance	$ 237,529	$ 327,052	$ 153,390	$ 84,139
Real Estate	75,957	93,056	55,031	20,926
Business credit	2,831	2,831		2,831
Total	$ 316,317	$ 422,939	$ 208,421	$ 107,896

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During the three months ended March 31, 2012 and 2011 the Company recorded net partial charge-offs of $2.9 million and $5.3 million, respectively. The Company s general policy is to record a specific allowance for an impaired loan with any partial charge-off of such loan occurring in a subsequent period. The Company may record the initial specific allowance related to an impaired loan in the same period as it records a partial charge-off in certain circumstances such as if the terms of a restructured loan are finalized during that period. When a loan is determined to be uncollectible, the specific allowance is charged off, and reduces the loan gross investment in the loan.

While charge-offs have no net impact on the carrying value of net loans, charge-offs lower the level of the allowance for loan losses; and, as a result, reduces the percentage of allowance for loans to total loans, and the percentage of allowance for loan losses to non-performing loans.

Below is a summary of the Company s evaluation of its portfolio and allowance for loan and lease losses by impairment methodology:

	Leveraged Finance		Real Estate		Business Credit	
March 31, 2012	**Investment**	**Allowance**	**Investment**	**Allowance**	**Investment**	**Allowance**
			($ in thousands)			
Collectively evaluated (1)	$ 1,273,485	$ 18,608	$ 159,124	$ 5,150	$ 148,734	$ 536
Individually evaluated (2)	232,662	29,356	63,560	10,026	2,095	
Total	$ 1,498,066	$ 47,964	$ 222,684	$ 15,176	$ 150,829	$ 536

	Leveraged Finance		Real Estate		Business Credit	
December 31, 2011	**Investment**	**Allowance**	**Investment**	**Allowance**	**Investment**	**Allowance**
			($ in thousands)			
Collectively evaluated (1)	$ 1,199,511	$ 16,062	$ 195,424	$ 6,586	$ 108,941	$ 374
Individually evaluated (2)	237,529	28,058	75,957	12,620	2,831	
Total	$ 1,437,040	$ 44,120	$ 271,381	$ 19,206	$ 111,772	$ 374

(1) Represents loans and leases collectively evaluated for impairment in accordance with ASC 450-20, *Loss Contingencies,* and pursuant to amendments by ASU 2010-20 regarding allowance for unimpaired loans and leases. These loans and leases had a weighted average risk rating of 5.3 based on the Company s internally developed 12 point scale at March 31, 2012 and December 31, 2011.

(2) Represents loans individually evaluated for impairment in accordance with ASU 310-10, *Receivables,* and pursuant to amendments by ASU 2010-20 regarding allowance for impaired loans.

Below is a summary of the Company s investment in nonaccrual loans.

Recorded Investment in Nonaccrual Loans	**March 31, 2012**	**December 31, 2011**
	($ in thousands)	
Leveraged Finance	$ 66,842	$ 78,214
Real Estate	8,210	21,115
Business Credit	2,095	2,831
Total	$ 77,147	$ 102,160

During the three months ended March 31, 2012, nonaccrual loans with an aggregate outstanding balance of $11.5 million were resolved as a result of workout processes with the borrowers.

Loans being restructured typically develop adverse performance trends as a result of internal or external factors, the result of which is an inability to comply with the terms of the applicable credit agreement governing their obligations to the Company. In order to mitigate default risk and/or liquidation, assuming that liquidation proceeds are not viewed as a more favorable outcome to the Company and other lenders, the Company will enter into negotiations with the borrower and its shareholders on the terms of a restructuring. When restructuring a loan, the Company undertakes an extensive diligence process which typically includes (i) construction of a financial model that runs through the tenor of the restructuring term, (ii) meetings with management of the borrower, (iii) engagement of third party consultants and (iv) internal analysis. Once a restructuring proposal is developed, it is subject to approval by both the Company s Underwriting Committee and the Company s Investment Committee. Loans will only be removed from TDR classification upon the refinancing of outstanding obligations on terms which are determined to be market in all material respects, or upon full payoff of the loan. The Company may modify loans that are not determined to be a TDR. Where a loan is modified or restructured but loan terms are considered market and no concessions were given on the loan terms, including price, principal amortization or obligation, or other restrictive covenants, a loan will not be classified as a TDR. The Company did not remove the TDR classification from any loan during the three months ended March 31, 2012. During the three months ended March 31, 2012, the Company, as a result of a troubled debt restructuring, netted deferred loan fees against the gross outstanding balance of a TDR.

The Company has made the following types of concessions in the context of a TDR:

Group I:

- extension of principal repayment term
- principal holidays
- interest rate adjustments

Group II:

- partial charge-offs
- partial forgiveness
- conversion of debt to equity

A summary of the types of concessions that the Company made with respect to TDRs at March 31, 2012 and December 31, 2011 is provided below:

	Group I	Group II
	($ in thousands)	
March 31, 2012	$ 245,535	$ 192,558
December 31, 2011	$ 243,509	$ 195,382

Note: A loan may be included in more than one type of restructuring.

For the three months ended March 31, 2012 and 2011, the Company had partial charge-offs totaling $0.5 million and $0, respectively related to loans previously classified as TDR. As of March 31, 2012, the Company had not removed the TDR classification from any loan previously identified as such.

The Company measures TDRs similarly to how it measures all loans for impairment. The Company performs a discounted cash flow analysis on cash flow dependent loans and we assess the underlying collateral value less reasonable costs of sale for collateral dependent loans. Management analyzes the projected performance of the borrower to determine if it has the ability to service principal and interest based on the terms of the restructuring. If a charge-off is taken on a restructured loan, interest will typically move to a cash basis where it is taken into income only upon receipt or be placed on nonaccrual. Loans will typically not be returned to accrual status until at least six months of contractual payments have been made in a timely manner. Typically a loan has had a specific allowance established for it in a period prior to it becoming a TDR. Additionally, at the time of a restructuring and quarterly thereafter, an impairment analysis is undertaken to determine the level of impairment on the loan.

Below is a summary of the Company s loans which were classified as TDR.

For the Three Months Ended March 31, 2012	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Investment in TDR Subsequently Defaulted
		($ in thousands)	
Leveraged Finance	$ 15,937	$ 15,937	$
Real Estate			
Business Credit			
Total	$ 15,937	$ 15,937	$

For the Year Ended December 31, 2011	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Investment in TDR Subsequently Defaulted
		($ in thousands)	
Leveraged Finance	$ 71,470	$ 71,470	$ 26,154
Real Estate			
Business Credit			
Total	$ 71,470	$ 71,470	$ 26,154

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The following sets forth a breakdown of troubled debt restructurings at March 31, 2012 and December 31, 2011:

As of March 31, 2012 ($ in thousands)	Accrual Status				For the three months
Loan Type	Accruing	Nonaccrual	Impaired Balance	Specific Allowance	Charged -off
Leveraged Finance	$ 144,347	$ 64,440	$ 208,787	$ 27,728	$ 472
Real Estate	32,287	4,461	36,748	4,709	
Business Credit					
Total	$ 176,634	$ 68,901	$ 245,535	$ 32,437	$ 472

As of December 31, 2011 ($ in thousands)	Accrual Status				For the year
Loan Type	Accruing	Nonaccrual	Impaired Balance	Specific Allowance	Charged-off
Leveraged Finance	$ 140,271	$ 75,492	$ 215,763	$ 26,266	$ 15,740
Real Estate	23,277	4,469	27,746	3,836	
Business Credit					
Total	$ 163,548	$ 79,961	$ 243,509	$ 30,102	$ 15,740

The Company classifies a loan as past due when it is over 60 days delinquent.

An age analysis of the Company s past due receivables is as follows:

March 31, 2012	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current ($ in thousands)	Total Loans	Investment in > 60 Days & Accruing
Leveraged Finance	$	$ 41,216	$ 41,216	$ 1,456,850	$ 1,498,066	$
Real Estate		8,210	8,210	214,474	222,684	
Business Credit				150,829	150,829	
Total	$	$ 49,246	$ 49,246	$ 1,822,153	$ 1,871,579	$
December 31, 2011						
Leveraged Finance	$ 23,940	$ 40,951	$ 64,891	$ 1,372,149	$ 1,437,040	$
Real Estate	15,834	13,719	29,553	241,828	271,381	8,438
Business Credit		2,831	2,831	108,941	111,772	
Total	$ 39,774	$ 57,501	$ 97,275	$ 1,722,918	$ 1,820,193	$ 8,438

A general allowance is provided for loans and leases that are not impaired. The Company employs a variety of internally developed and third-party modeling and estimation tools for measuring credit risk, which are used in developing an allowance for loan and lease losses on outstanding loans and leases. The Company s allowance framework addresses economic conditions, capital market liquidity and industry circumstances from both a top-down and bottom-up perspective. The Company considers and evaluates changes in economic conditions, credit availability, industry and multiple obligor concentrations in assessing both probabilities of default and loss severities as part of the general component of the allowance for loan and lease losses.

On at least a quarterly basis, loans and leases are internally risk-rated based on individual credit criteria, including loan and lease type, loan and lease structures (including balloon and bullet structures common in the Company s Leveraged Finance and Real Estate cash flow loans), borrower industry, payment capacity, location and quality of collateral if any (including the Company s Real Estate loans). Borrowers provide the Company with financial information on either a monthly or quarterly basis. Ratings, corresponding assumed default rates and assumed loss severities are dynamically updated to reflect any changes in borrower condition or profile.

For Leveraged Finance loans and equipment finance leases, the data set used to construct probabilities of default in its allowance for loan losses model, Moody s CRD Private Firm Database, primarily contains middle market loans that share attributes similar to the Company s loans. The Company also considers the quality of the loan or lease terms in determining a loan loss in the event of default.

For Real Estate loans, the Company employs two mechanisms to capture the impact of industry and economic conditions. First, a loan s risk rating, and thereby its assumed default likelihood, can be adjusted to account for overall commercial real estate market conditions. Second, to the extent that economic or industry trends adversely affect a substandard rated borrower s loan-to-value ratio enough to impact its repayment ability, the Company applies a stress multiplier to the loan s probability of default. The multiplier is designed to account for default characteristics that are difficult to quantify when market conditions cause commercial real estate prices to decline.

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For Business Credit loans, the Company utilizes a proprietary model to risk rate the loans on a monthly basis. This model captures the impact of changes in industry and economic conditions as well as changes in the quality of the borrower s collateral and financial performance to assign a final risk rating. The Company has also evaluated historical loss trends by risk rating from a comprehensive industry database covering more than twenty five years of experience of the majority of the asset based lenders operating in the United States. Based upon the monthly risk rating from the model, the reserve is adjusted to reflect the historical average for expected loss from the industry database.

If the Company determines that additional changes in its allowance for credit losses methodology are advisable, as a result of changes in the economic environment or otherwise, the revised allowance methodology may result in higher or lower levels of allowance. Moreover, given uncertain market conditions, actual losses under the Company s current or any revised allowance methodology may differ materially from the Company s estimate.

Additionally, when determining the amount of the general allowance, the Company supplements the base amount with a judgmental amount which is governed by a score card system comprised of ten individually weighted risk factors. The risk factors are designed based on those outlined in the Comptrollers of the Currency s Allowance for Loan and Lease Losses Handbook. The Company also performs a ratio analysis of comparable money center banks, regional banks and finance companies. While the Company does not rely on this peer group comparison to set the level of allowance for credit losses, it does assist management in identifying market trends and serves as an overall reasonableness check on the allowance for credit losses computation. During 2011, the Company reduced its general allowance for credit losses by five basis points to reflect improving performance in its non-impaired loan portfolio.

A loan is considered impaired when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impairment of a loan is based upon (i) the present value of expected future cash flows discounted at the loan s effective interest rate, (ii) the loan s observable market price, or (iii) the fair value of the collateral if the loan is collateral dependent, depending on the circumstances and our collection strategy. Impaired loans are identified based on the loan-by-loan risk rating process described above. It is the Company s policy during the reporting period to record a specific provision for credit losses for all loans for which we have serious doubts as to the ability of the borrowers to comply with the present loan repayment terms.

A summary of the activity in the allowance for credit losses is as follows:

	Three Months Ended March 31, 2012			
	Leveraged Finance	Real Estate	Business Credit	Total
	($ in thousands)			
Balance, beginning of year	$ 44,553	$ 19,185	$ 374	$ 64,112
Provision for credit losses general	2,560	(1,409)	162	1,313
Provision for credit losses specific	758	810		1,568
Loans charged off, net of recoveries	540	(3,404)		(2,864)
Balance, end of period	$ 48,411	$ 15,182	$ 536	$ 64,129
Balance, end of period specific	$ 29,356	$ 10,026	$	$ 39,382
Balance, end of period general	$ 19,055	$ 5,156	$ 536	$ 24,747
Average balance of impaired loans	$ 248,504	$ 79,364	$ 2,852	$ 330,720
Interest recognized from impaired loans	$ 3,477	$ 298	$	$ 3,775
Loans				
Loans individually evaluated with specific allowance	$ 142,930	$ 46,729	$	$ 189,659
Loans individually evaluated with no specific allowance	81,651	16,831		98,482
Loans acquired with deteriorating credit quality			2,095	2,095
Loans collectively evaluated without specific allowance	1,273,485	159,124	148,734	1,581,343
Total loans and leases	$ 1,498,066	$ 222,684	$ 150,829	$ 1,871,579

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	Leveraged Finance	Real Estate	Business Credit	Total
	Three Months Ended March 31, 2011			
	($ in thousands)			
Balance, beginning of year	$ 58,912	$ 25,869	$	$ 84,781
Provision for credit losses general	617	(481)	38	174
Provision for credit losses specific	6,756	(677)		6,079
Loans charged off, net of recoveries	(5,322)			(5,322)
Balance, end of period	$ 60,963	$ 24,711	$ 38	$ 85,712
Balance, end of period specific	$ 42,746	$ 18,323	$ 38	$ 61,107
Balance, end of period general	$ 18,217	$ 6,388	$	$ 24,605
Average balance of impaired loans	$ 262,024	$ 87,460	$ 8,134	$ 357,618
Interest recognized from impaired loans	$ 3,373	$ 725	$ 150	$ 4,248
Loans				
Loans individually evaluated with specific allowance	$ 164,307	$ 79,078	$	$ 243,385
Loans individually evaluated with no specific allowance	90,117	8,438		98,555
Loans acquired with deteriorating credit quality			5,001	5,001
Loans collectively evaluated without specific allowance	1,125,994	189,980	59,989	1,375,963
Total loans	$ 1,380,418	$ 277,496	$ 64,990	$ 1,722,904

During the three months ended March 31, 2012, the Company recorded a total provision for credit losses of $2.9 million. The Company maintained its allowance for credit losses at $64.1 million as of March 31, 2012 and at December 31, 2011. The Company had $2.9 million of charge offs of impaired loans with a specific allowance during the three months ended March 31, 2012, offset by new specific provisions for credit losses and general provisions for credit losses due to loan growth. The general allowance for credit losses covers probable losses in the Company s loan and lease portfolio with respect to loans and leases for which no specific impairment has been identified. A specific provision for credit losses is recorded with respect to loans for which it is probable that the Company will be unable to collect all amounts due in accordance with the contractual terms of the loan agreement for which there is impairment recognized. The outstanding balance of impaired loans, which include all of the outstanding balances of the Company s delinquent loans and its troubled debt restructurings, as a percentage of Loans and leases, net decreased to 16% as of March 31, 2012 as compared to 19% as of December 31, 2011. When a loan is classified as impaired, the loan is evaluated for a specific allowance and a specific provision may be recorded, thereby removing it from consideration under the general component of the allowance analysis. Loans that are deemed to be uncollectible are charged off and deducted from the allowance, and recoveries on loans previously charged off are netted against loans charged off.

The Company closely monitors the credit quality of its loans and leases which is partly reflected in its credit metrics such as loan delinquencies, non-accruals and charge offs. Changes in these credit metrics are largely due to changes in economic conditions and seasoning of the loan and lease portfolio.

Included in the allowance for credit losses at March 31, 2012 and December 31, 2011 is an allowance for unfunded commitments of $0.5 million and $0.4 million, respectively, which is recorded as a component of other liabilities on the Company s consolidated balance sheet with changes recorded in the provision for credit losses on the Company s consolidated statement of operations. The methodology for determining the allowance for unfunded commitments is consistent with the methodology for determining the allowance for loan and lease losses.

Based on the Company s evaluation process to determine the level of the allowance for loan and lease losses, management believes the allowance to be adequate as of March 31, 2012 in light of the estimated known and inherent risks identified through its analysis. The Company continually evaluates the appropriateness of its allowance for credit losses methodology.

During the three months ended March 31, 2012, as part of the resolution of an impaired commercial real estate loan, the Company took control of the underlying commercial real estate property. The Company recorded a partial charge-off of $2.7 million and classified the commercial real estate property as other real estate owned. The commercial real estate property had a fair value of $9.4 million as of March 31, 2012.

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Note 4. Restricted Cash

Restricted cash as of March 31, 2012 and December 31, 2011 was as follows:

	March 31, 2012	December 31, 2011
	($ in thousands)	
Collections on loans pledged to credit facilities	$ 61,429	$ 22,137
Principal and interest collections on loans held in trust and prefunding amounts	40,337	57,994
Customer escrow accounts	3,185	3,684
Total	$ 104,951	$ 83,815

Note 5. Investments in Debt Securities, Available-for-Sale

Amortized cost of investments in debt securities as of March 31, 2012 and December 31, 2011 was as follows:

	March 31, 2012	December 31, 2011
	($ in thousands)	
Investments in debt securities - gross	$ 25,298	$ 25,298
Unamortized discount	(4,492)	(4,548)
Investments in debt securities - amortized cost	$ 20,806	$ 20,750

The amortized cost, gross unrealized holding gains, gross unrealized holding losses, and fair value of available-for-sale securities at March 31, 2012 and December 31, 2011 were as follows:

	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
	($ in thousands)			
March 31, 2012:				
Collateralized loan obligations	$ 20,806	$	$ (1,768)	$ 19,038
	$ 20,806	$	$ (1,768)	$ 19,038

	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
	($ in thousands)			
December 31, 2011:				
Collateralized loan obligations	$ 20,750	$	$ (2,933)	$ 17,817
	$ 20,750	$	$ (2,933)	$ 17,817

The Company did not sell any debt securities during the three months ended March 31, 2012 and 2011.

The Company did not record any net Other-Than-Temporary Impairment charges during the three months ended March 31, 2012 and 2011.

The following is an analysis of the continuous periods during which the Company has held investment positions which were carried at an unrealized loss as of March 31, 2012 and December 31, 2011:

	March 31, 2012		
	Less than 12 Months	Greater than or Equal to 12 Months	Total
	($ in thousands)		
Number of positions	5		5
Fair value	$ 19,038	$	$ 19,038
Amortized cost	20,806		20,806
Unrealized loss	$ 1,768	$	$ 1,768

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	December 31, 2011		
	Less than 12 Months	Greater than or Equal to 12 Months	Total
	($ in thousands)		
Number of positions	5		5
Fair value	$ 17,817	$	$ 17,817
Amortized cost	20,750		20,750
Unrealized loss	$ 2,933	$	$ 2,933

As a result of the Company s evaluation of the securities, management concluded that the unrealized losses at March 31, 2012 and December 31, 2011 were caused by changes in market prices driven by interest rates and credit spreads. The Company s evaluation of impairment included adjustments to prepayment speeds, delinquency, an analysis of expected cash flows, interest rates, market discount rates, other contract terms, and the timing and level of losses on the loans and leases within the underlying trusts. At March 31, 2012, the Company has determined that it is not more likely than not that it will be required to sell the securities before the Company recovers its amortized cost basis in the security. The Company has also determined that there has not been an adverse change in the cash flows expected to be collected. Based upon the Company s impairment review process, and the Company s ability and intent to hold these securities until maturity or a recovery of fair value, the decline in the value of these investments is not considered to be Other Than Temporary.

Maturities of debt securities classified as available-for-sale were as follows at March 31, 2012 and December 31, 2011 (maturities of asset-backed and mortgage-backed securities have been allocated based upon estimated maturities, assuming no change in the current interest rate environment):

	March 31, 2012		December 31, 2011	
	Amortized cost	Fair value	Amortized cost	Fair value
	($ in thousands)			
Available-for-sale:				
Due one year or less	$	$	$	$
Due after one year through five years				
Due after five years through ten years	20,806	19,038	20,750	17,817
Total	$ 20,806			