

NewStar Financial, Inc.  
Form 10-Q  
August 04, 2010  
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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 June 30, 2010

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)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**54-2157878**  
(I.R.S. Employer  
Identification No.)

**500 Boylston Street, Suite 1250,**  
**Boston, MA**  
(Address of principal executive offices)

**02116**  
(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  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  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   
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

As of August 2, 2010, 51,428,620 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;

expected results of operation;

ability to meet draw requests under commitments to borrowers under certain conditions;

growth and market opportunities;

future development of our products and markets;

ability to compete; and

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 the recent 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

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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, 2009.

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.

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements.****NEWSTAR FINANCIAL, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
	(\$ in thousands, except share and par value amounts)	
<b>Assets:</b>		
Cash and cash equivalents	\$ 39,970	\$ 39,848
Restricted cash	146,648	136,884
Investments in debt securities, available-for-sale	4,022	4,183
Loans held-for-sale, net	10,624	15,736
Loans, net	1,700,354	1,878,978
Deferred financing costs, net	19,486	18,557
Interest receivable	7,629	7,949
Property and equipment, net	843	976
Deferred income taxes, net	54,905	56,449
Income tax receivable	10,731	7,260
Other assets	21,600	33,252
<b>Total assets</b>	<b>\$ 2,016,812</b>	<b>\$ 2,200,072</b>
<b>Liabilities:</b>		
Credit facilities	\$ 59,326	\$ 91,890
Term debt	1,381,398	1,523,052
Accrued interest payable	6,179	2,774
Accounts payable	229	645
Other liabilities	26,190	31,591
<b>Total liabilities</b>	<b>1,473,322</b>	<b>1,649,952</b>
<b>Stockholders equity and noncontrolling interest:</b>		
Preferred stock, par value \$0.01 per share (5,000,000 shares authorized; no shares outstanding)		
Common stock, par value \$0.01 per share:		
Shares authorized: 145,000,000 in 2010 and 2009;		
Shares outstanding 51,637,820 in 2010 and 49,994,858 in 2009	516	500
Additional paid-in capital	621,001	616,762
Accumulated deficit	(73,686)	(69,083)
Common stock held in treasury, at cost \$0.01 par value; 633,334 in 2010 and 257,392 in 2009	(3,731)	(1,331)
Accumulated other comprehensive loss, net	(610)	(786)
<b>Total NewStar Financial, Inc. stockholders equity</b>	<b>543,490</b>	<b>546,062</b>
Noncontrolling interest		4,058
<b>Total stockholders equity</b>	<b>543,490</b>	<b>550,120</b>

<b>Total liabilities and stockholders equity</b>	\$ 2,016,812	\$ 2,200,072
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The accompanying notes are an integral part of these condensed consolidated financial statements.

**Table of Contents****NEWSTAR FINANCIAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****Unaudited**

	<b>Three Months Ended June 30, 2010</b>		<b>Six Months Ended June 30, 2009</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
	<b>(\$ in thousands, except per share amounts)</b>			
<b>Net interest income:</b>				
Interest income	\$ 28,218	\$ 35,026	\$ 57,321	\$ 70,951
Interest expense	9,160	11,412	22,209	25,177
Net interest income	19,058	23,614	35,112	45,774
Provision for credit losses	5,542	36,177	32,589	61,484
Net interest income (loss) after provision for credit losses	13,516	(12,563)	2,523	(15,710)
<b>Non-interest income:</b>				
Fee income	343	361	724	854
Asset management income related party	681	673	1,332	1,460
Gain on derivatives	125	222	143	366
Loss on sale of loans	(113)		(113)	
Other income (expense)	3,727	(1,504)	7,248	3,394
Total non-interest income (loss)	4,763	(248)	9,334	6,074
<b>Operating expenses:</b>				
Compensation and benefits	6,182	6,686	12,566	12,313
Occupancy and equipment	450	781	1,094	1,561
General and administrative expenses	2,911	4,573	5,676	8,074
Total operating expenses	9,543	12,040	19,336	21,948
<b>Income (loss) before income taxes</b>	<b>8,736</b>	<b>(24,851)</b>	<b>(7,479)</b>	<b>(31,584)</b>
Income tax expense (benefit)	3,310	(9,208)	(3,063)	(10,991)
<b>Net income (loss) before noncontrolling interest</b>	<b>5,426</b>	<b>(15,643)</b>	<b>(4,416)</b>	<b>(20,593)</b>
Net income attributable to noncontrolling interest	(98)		(187)	
<b>Net income (loss) attributable to NewStar Financial, Inc. common stockholders</b>	<b>\$ 5,328</b>	<b>\$ (15,643)</b>	<b>\$ (4,603)</b>	<b>\$ (20,593)</b>
<b>Basic income (loss) per share</b>	<b>\$ 0.11</b>	<b>\$ (0.32)</b>	<b>\$ (0.09)</b>	<b>\$ (0.42)</b>
<b>Diluted income (loss) per share</b>	<b>0.10</b>	<b>(0.32)</b>	<b>(0.09)</b>	<b>(0.42)</b>

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 (\$ in thousands)	Equity Accumulated Other Comprehensive Loss, net	Common Stockholders Equity	Noncontrolling Interest
<b>Balance at January 1, 2010</b>	\$ 500	\$ 616,762	\$ (69,083)	\$ (1,331)	\$ (786)	\$ 546,062	\$ 4,058
Net income (loss)			(4,603)			(4,603)	187
Other comprehensive income:							
Net unrealized securities losses, net of tax expense of \$31					(47)	(47)	
Net unrealized derivatives gains, net of tax expense of \$119					223	223	
Total comprehensive income						(4,427)	
Distributions from noncontrolling interest							(4,245)
Issuance of restricted stock	20	(20)					
Shares reacquired from employee transactions	(1)			(546)		(547)	
Tax benefit from vesting of restricted common stock awards		351				351	
Repurchase of common stock	(3)	3		(1,854)		(1,854)	
Amortization of restricted common stock awards		2,359				2,359	
Amortization of stock option awards		1,546				1,546	
<b>Balance at June 30, 2010</b>	\$ 516	\$ 621,001	\$ (73,686)	\$ (3,731)	\$ (610)	\$ 543,490	\$

	NewStar Financial, Inc. Stockholders Equity						
	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock (\$ in thousands)	Equity Accumulated Other Comprehensive Loss, net	Common Stockholders Equity	Noncontrolling Interest
<b>Balance at January 1, 2009</b>	\$ 486	\$ 608,996	\$ (24,823)	\$ (1,078)	\$ (2,026)	\$ 581,555	\$
Net loss			(20,593)			(20,593)	
Other comprehensive income:							
Net unrealized securities gains, net of tax expense of \$22					27	27	
Net unrealized derivatives gains, net of tax expense of \$264					183	183	
Total comprehensive income						(20,383)	
Issuance of restricted stock	6	(6)					
Shares reacquired from employee transactions				(9)		(9)	
Amortization of restricted common stock awards		2,063				2,063	

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Amortization of stock option awards 1,548 1,548

**Balance at June 30, 2009** \$ 492 \$ 612,601 \$ (45,416) \$ (1,087) \$ (1,816) \$ 564,774 \$

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

**Table of Contents****NEWSTAR FINANCIAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****Unaudited**

	<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(\$ in thousands)</b>	
<b>Cash flows from operating activities:</b>		
Net loss	\$ (4,603)	\$ (20,593)
Adjustments to reconcile net income (loss) to net cash used for operations:		
Provision for credit losses	32,589	61,484
Depreciation and amortization and accretion	(4,445)	(5,444)
Amortization of debt issuance costs	8,041	3,245
Equity compensation expense	4,256	3,610
Loss on sale of loans	113	
Gain on repurchase of debt	(6,733)	(3,480)
Loss on sale of other real estate owned		1,921
Net change in deferred income taxes	1,694	(17,635)
Loans held-for-sale originated	(29,081)	
Proceeds from sale of loans held-for-sale	34,193	
Net change in interest receivable	320	1,923
Net change in other assets	(8,469)	13,022
Net change in accrued interest payable	3,405	(5,490)
Net change in accounts payable and other liabilities	1,366	(9,151)
<b>Net cash provided by operating activities</b>	<b>32,646</b>	<b>23,412</b>
<b>Cash flows from investing activities:</b>		
Net change in restricted cash	(9,764)	(29,080)
Net change in loans	150,900	129,826
Proceeds from the sale of other real estate owned	5,331	4,049
Proceeds from repayments of debt securities available-for-sale	140	157
Acquisition of property and equipment	(31)	34
<b>Net cash provided by investing activities</b>	<b>146,576</b>	<b>104,986</b>
<b>Cash flows from financing activities:</b>		
Borrowings on credit facilities	37,515	30,537
Repayment of borrowings on credit facilities	(70,080)	(119,556)
Issuance of term debt	187,304	
Borrowings on term debt	1,500	22,000
Repayment of borrowings on term debt	(323,969)	(64,071)
Payment of deferred financing costs	(8,970)	(1,298)
Purchase of treasury stock	(2,400)	(9)
<b>Net cash provided by (used in) financing activities</b>	<b>(179,100)</b>	<b>(132,397)</b>
<b>Net increase (decrease) in cash during the period</b>	<b>122</b>	<b>(3,999)</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>39,848</b>	<b>50,279</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 39,970</b>	<b>\$ 46,280</b>

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**Supplemental cash flows information:**

Interest paid	\$ 18,804	\$ 30,667
Taxes paid		5,381
Decrease (increase) in fair value of investments in debt securities	78	(49)
Transfers of loans, net to loans held-for-sale		7,909

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 commercial finance company that provides customized debt financing solutions to middle market businesses and commercial real estate borrowers and manages investment funds for large institutional investors. The Company principally focuses on the direct origination of loans that meet its risk and return parameters. The Company's direct origination efforts target mid-sized companies, private equity sponsors, corporate executives, regional banks, real estate investors and a variety of other financial intermediaries to source transaction opportunities. Direct origination provides direct access to customers' management, enhances due diligence, and allows significant input into customers' capital structure and direct negotiation of transaction pricing and terms.

The Company operates as a single segment and derives its revenues from two specialized lending groups:

*Middle Market Corporate*, which originates, structures and underwrites senior debt and, to a lesser extent, second lien, mezzanine and subordinated debt, and equity and other equity-linked products for companies with annual EBITDA typically between \$5 million and \$50 million; and

*Commercial Real Estate*, which originates, structures and underwrites first mortgage debt and, to a lesser extent, subordinated debt, primarily to finance acquisitions of real estate properties typically valued between \$10 million and \$50 million.

Subsequent to December 31, 2007, the Company discontinued the origination of structured products. The Company manages its remaining structured products portfolio within its Middle Market Corporate lending group. As of June 30, 2010, this portfolio had an outstanding balance of \$23.9 million.

The Company has not originated any new commercial real estate loans since the first quarter of 2008.

**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, 2009.

***Noncontrolling Interest***

During 2009, the Company along with a wholly-owned subsidiary of the NewStar Credit Opportunities Fund, Ltd. (NCOF) created a limited liability company as part of the resolution of a commercial real estate loan. The limited liability company was formed to take control of the underlying commercial real estate property which was its sole asset. The Company maintained a majority and controlling interest in the limited liability company which was classified as other real estate owned (OREO). On May 11, 2010, the limited liability company sold the commercial real estate property.

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The consolidated financial statements include the results of operations of the Company as well as the NCOF's noncontrolling interest of the limited liability company which previously owned the OREO. All significant intercompany balances and transactions have been eliminated in consolidation. The noncontrolling interest represents the minority partner's equity and accumulated earnings in the limited liability company. The NCOF's noncontrolling interest had no recourse to the Company.

**Table of Contents****NEWSTAR FINANCIAL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Unaudited*****Recently Adopted Accounting Standards***

On June 12, 2009, the FASB issued ASC 860 (formerly SFAS 166, *Accounting for Transfers of Financial Assets*) and ASC 810 (formerly SFAS 167, *Amendments to FASB Interpretation No. 46(R)*). ASC 860 eliminates the concept of a qualifying special-purpose entity ( QSPE ) and, accordingly, any existing QSPE must be evaluated for consolidation upon adoption of ASC 860. Under ASC 860, the appropriateness of derecognition is evaluated based on whether or not the transferor has surrendered control of the transferred assets. The evaluation must consider any continuing involvement by the transferor. ASC 810 amends FIN 46R to require a reporting entity to perform an analysis to determine if its variable interests give it a controlling financial interest in a variable interest entity ( VIE ). The analysis required under ASC 810 identifies the primary beneficiary of a VIE as the entity having both of the following: (1) the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (2) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE.

In addition, a reporting entity must assess whether it has an implicit financial responsibility to ensure that a VIE operates as designed when determining if it has the power to direct the activities of the VIE that most significantly affect the entity's economic performance. ASC 810 amends FIN 46R to require ongoing reassessments of whether a reporting entity is the primary beneficiary of a VIE. Specifically, the list of reconsideration events includes a change in facts and circumstances where the holders of an equity investment at risk as a group lose the power to direct the activities of the entity that most significantly affect the entity's economic performance. In addition, a troubled debt-restructuring is now defined as a reconsideration event. Both statements expand required disclosures and are effective as of the beginning of the first annual reporting period that begins after November 15, 2009. The adoption of ASC 860 and ASC 810 did not have a material effect on the Company's results from operation or financial position.

***Recently Issued Accounting Standards***

In January 2010, the FASB issued ASU 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU 2010-06 provides amendments to Topic 820 that require new disclosures about (1) the different classes of assets and liabilities measured at fair value, (2) the valuation techniques and inputs used, (3) the activity in Level 3 fair value measurements, and (4) the transfers between Levels 1, 2, and 3. The new disclosures regarding the activity in Level 3 fair value measurements is effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Early adoption is permitted. All other requirements of ASU 2010-06 are effective in interim and annual periods beginning after December 15, 2009. The adoption of ASU 2010-06 did not have a material effect on the Company's results from operations or financial position. The adoption of the requirements effective in 2011 is not expected to have a material effect on the Company's results from operations or financial position.

In July 2010, the FASB issued ASU 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU 2010-20 amends Topic 310 to provide greater transparency about an entity's allowance for credit losses and the credit quality of its financing receivables. The new disclosures as of the end of the reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The new disclosures about activity that occurs during a reporting period are effective for interim and annual reporting beginning ending on or after December 15, 2010. The adoption of ASU 2010-20 will not have a material effect on the Company's results from operations or financial position.

**Note 3. Fair Value**

ASC 820, *Fair Value Measurements* ( ASC 820 ) establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

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Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.



**Table of Contents****NEWSTAR FINANCIAL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Unaudited**

The following table presents recorded amounts of assets and liabilities measured at fair value on a recurring and nonrecurring basis as of June 30, 2010, by caption in the consolidated balance sheet and by ASC 820 valuation hierarchy (as described above).

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Carrying Value in Consolidated Balance Sheet
	(\$ in thousands)			
<b>Recurring Basis:</b>				
Investments in debt securities, available-for-sale	\$	\$	\$ 4,022	\$ 4,022
Warrants			5,305	5,305
Derivatives interest rate contracts (assets)		5,251		5,251
<b>Total assets recorded at fair value on a recurring basis</b>	<b>\$</b>	<b>\$ 5,251</b>	<b>\$ 9,327</b>	<b>\$ 14,578</b>
Derivatives interest rate contracts (liabilities)	\$	\$ 5,687	\$	\$ 5,687
<b>Nonrecurring Basis:</b>				
Loans, net	\$	\$	\$ 78,809	\$ 78,809
Loans held-for-sale, net	10,624			10,624
Other real estate owned			3,400	3,400
<b>Total assets recorded at fair value on a nonrecurring basis</b>	<b>\$ 10,624</b>	<b>\$</b>	<b>\$ 82,209</b>	<b>\$ 92,833</b>

At June 30, 2010, Loans, net measured at fair value on a nonrecurring basis consisted of impaired collateral-dependent commercial real estate loans. The fair values of these loans are based on third party appraisals of the underlying collateral value as well as the Company's internal analysis. During 2010, the Company recorded \$12.7 million of specific provision for credit losses related to Loans, net measured at fair value.

At June 30, 2010, Loans held-for-sale, net consisted of middle market corporate loans intended to be sold to the NCOF. The fair values of the loans are based on contractual selling prices.

At June 30, 2010, Other real estate owned consisted of one commercial real estate property.

The following table presents recorded amounts of assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2009, by caption in the consolidated balance sheet and by ASC 820 valuation hierarchy (as described above).

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Carrying Value in Consolidated Balance Sheet
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	(\$ in thousands)			
<b>Recurring Basis:</b>				
Investments in debt securities, available-for-sale	\$	\$	\$ 4,183	\$ 4,183
Warrants			1	1
Derivatives (assets)		7,458		7,458
<b>Total assets recorded at fair value on a recurring basis</b>	<b>\$</b>	<b>\$ 7,458</b>	<b>\$ 4,184</b>	<b>\$ 11,642</b>
Derivatives (liabilities)	\$	\$ 7,853	\$	\$ 7,853
<b>Nonrecurring Basis:</b>				
Loans, net	\$	\$	\$ 46,182	\$ 46,182
Loans held-for-sale, net	15,736			15,736
Other real estate owned			13,413	13,413
<b>Total assets recorded at fair value on a nonrecurring basis</b>	<b>\$ 15,736</b>	<b>\$</b>	<b>\$ 59,595</b>	<b>\$ 75,331</b>

At December 31, 2009, Loans, net measured at fair value on a nonrecurring basis consisted of impaired collateral-dependent commercial real estate loans. The fair values of these loans are based on third party appraisals of the underlying collateral value as well as the Company's internal analysis. During 2009, the Company recorded \$33.3 million of specific provision for credit losses related to Loans, net measured at fair value.

**Table of Contents****NEWSTAR FINANCIAL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Unaudited**

At December 31, 2009, Loans held-for-sale, net consisted of middle market corporate loans intended to be sold to the NCOF. The fair values of the loans are based on contractual selling prices.

At December 31, 2009, Other real estate owned consisted of two commercial real estate properties. During 2009, the Company recorded a loss of \$3.9 million due to the decline in fair value of one of the commercial real estate properties.

***Changes in level 3 recurring fair value measurements***

The table below illustrates the change in balance sheet amounts during the three and six months ended June 30, 2010 and 2009 (including the change in fair value), for financial instruments measured on a recurring basis and classified by the Company as level 3 in the valuation hierarchy. When a determination is made to classify a financial instrument as level 3, the determination is based upon the significance of the unobservable parameters to the overall fair value measurement. However, level 3 financial instruments typically include, in addition to the unobservable or level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources); accordingly, the gains and losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology. The Company did not transfer any financial instruments in or out of level 3 during the three or six months ended June 30, 2010.

For the three months ended June 30, 2010:

	<b>Investments in Debt Securities, Available-for-sale</b>	<b>Warrants</b>
	(\$ in thousands)	
Balance as of March 31, 2010	\$ 4,051	\$ 1
Total gains or losses (realized/unrealized)		
Included in earnings		(1)
Included in other comprehensive income	19	
Purchases, issuances or settlements	(48)	5,305
Balance as of June 30, 2010	\$ 4,022	\$ 5,305

For the three months ended June 30, 2009:

	<b>Investments in Debt Securities, Available-for-sale</b>	<b>Warrants</b>
	(\$ in thousands)	
Balance as of March 31, 2009	\$ 2,676	\$ 1
Total gains or losses (realized/unrealized)		
Included in earnings		
Included in other comprehensive income	332	
Purchases, issuances or settlements	(36)	

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Balance as of June 30, 2009 \$ 2,972 \$ 1

For the six months ended June 30, 2010:

	<b>Investments in Debt Securities, Available-for-sale (\$ in thousands)</b>	<b>Warrants</b>
Balance as of December 31, 2009	\$ 4,183	\$ 1
Total gains or losses (realized/unrealized)		
Included in earnings		(1)
Included in other comprehensive income	(78)	
Purchases, issuances or settlements	(83)	5,305
Balance as of June 30, 2010	\$ 4,022	\$ 5,305

**Table of Contents****NEWSTAR FINANCIAL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Unaudited**

For the six months ended June 30, 2009:

	<b>Investments in Debt Securities, Available-for-sale</b>	<b>Warrants</b>
	(\$ in thousands)	
Balance as of December 31, 2008	\$ 3,025	\$ 2,500
Total gains or losses (realized/unrealized)		
Included in earnings		(500)
Included in other comprehensive income	49	
Purchases, issuances or settlements	(102)	(1,999)
Balance as of June 30, 2009	\$ 2,972	\$ 1

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments at June 30, 2010 and December 31, 2009. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties.

	June 30, 2010		December 31, 2009	
	Carrying amount	Fair value	Carrying amount	Fair value
	(\$ in thousands)			
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 39,970	\$ 39,970	\$ 39,848	\$ 39,848
Restricted cash	146,648	146,648	136,884	136,884
Loans held-for-sale	10,624	10,624	15,736	15,736
Loans, net	1,700,354	1,671,796	1,878,978	1,828,702
Investments in debt securities available-for-sale	4,022	4,022	4,183	4,183
Derivative instruments	5,251	5,251	7,458	7,458
<b>Financial liabilities:</b>				
Credit facilities	\$ 59,326	\$ 59,326	\$ 91,890	\$ 91,890
Term debt	1,381,398	1,242,555	1,523,052	1,452,361
Derivatives instruments	5,687	5,687	7,853	7,853

The carrying amounts shown in the table are included in the consolidated balance sheets under the indicated captions.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

*Cash and cash equivalents and restricted cash:* The carrying amounts approximate fair value because of the short maturity of these instruments.

*Loans held-for-sale, net:* The fair values are based on quoted prices, where available, or are determined by discounting estimated cash flows using model-based valuation techniques. Inputs into the model-based valuations can include changes in market indexes, selling prices of similar loans, management's assumption related to credit rating of the loan, prepayment assumptions and other factors, such as credit loss assumptions.

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*Loans, net:* The fair value was determined as the present value of expected future cash flows discounted at current market interest rates offered by similar lending institutions for loans with similar terms to companies with comparable credit risk. This method of estimating fair value does not incorporate the exit price concept of fair value prescribed by ASC 820-10.

*Investments in debt securities:* The fair values of debt securities are based on quoted market prices, when available, at the reporting date for those or similar investments. When no market data is available, we estimate fair value using various valuation tools including cash flow models that utilize financial statements and business plans, as well as qualitative factors.

*Credit facilities:* Due to the adjustable rate nature of the borrowings, the fair value of the credit facilities are estimated to be their carrying values. Rates currently are comparable to those offered to the Company for similar debt instruments of comparable maturities by the Company's lenders.

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*Term debt:* The fair value was determined by applying prevailing term debt market interest rates to the Company's current term debt structure.

*Derivative instruments:* Substantially all derivative instruments held or issued by the Company for risk management or customer-initiated activities are traded in over-the-counter markets where quoted market prices are not readily available. For those derivatives, the Company measures fair value using broker quotes or financial models that use primarily market observable inputs, such as yield curves and option volatilities, and include the value associated with the counterparty credit risk.

### Note 4. Loans Held-for-Sale, Loans and Allowance for Credit Losses

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 NCOF) or impaired loans for which a sale of the loan is expected as a result of a workout strategy. At June 30, 2010 loans held-for-sale consisted of middle market loans to three borrowers which are intended to be sold to the NCOF at an agreed upon price. Subsequent to June 30, 2010, the Company sold loans with an aggregate outstanding balance of \$7.8 million to the NCOF.

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

As of June 30, 2010 and December 31, 2009, loans held-for-sale consisted of the following:

	June 30, 2010	December 31, 2009
	(\$ in thousands)	
Middle Market Corporate	\$ 10,846	\$ 15,990
Gross loans	10,846	15,990
Deferred loan fees, net	(222)	(254)
Total loans, net	\$ 10,624	\$ 15,736

The Company sold two loans for a loss of \$0.1 million to entities other than the NCOF during the six months ended June 30, 2010. The Company did not sell any loans to entities other than the NCOF during the six months ended June 30, 2009.

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As of June 30, 2010 and December 31, 2009, loans consisted of the following:

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
	(\$ in thousands)	
Middle Market Corporate	\$ 1,511,250	\$ 1,692,929
Commercial Real Estate	309,735	320,659
<b>Gross loans</b>	<b>1,820,985</b>	<b>2,013,588</b>
Deferred loan fees, net	(20,689)	(20,745)
Allowance for loan losses	(99,942)	(113,865)
<b>Total loans, net</b>	<b>\$ 1,700,354</b>	<b>\$ 1,878,978</b>

The Company grants commercial loans and real estate loans to customers throughout the United States. Although the Company has a diversified loan 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.

As of June 30, 2010, the Company had impaired loans with an aggregate outstanding balance of \$333.2 million. Impaired loans with an aggregate outstanding balance of \$235.1 million have been restructured and classified as troubled debt restructurings ( TDR ) as defined by ASC 310, Accounting for Debtors and Creditors for Troubled Debt Restructurings ( ASC 310 ). Impaired loans with an aggregate outstanding balance of \$146.5 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 and six months ended June 30, 2010, the Company recorded \$14.2 million and \$36.5 million of specific provisions for impaired loans. At June 30, 2010, the Company had a \$65.6 million specific allowance for impaired loans with an aggregate outstanding balance of \$244.6 million. At June 30, 2010, additional funding commitments for impaired loans totaled \$27.9 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, or if the borrower is not in compliance additional funding commitments may be made at the Company's discretion. As of June 30, 2010, \$120.7 million of impaired loans were greater than 60 days past due and classified as delinquent by the Company. Included in the \$65.6 million specific allowance for impaired loans was \$28.9 million related to delinquent loans. Additionally, the Company had a \$10.0 million commercial real estate loan which was over 90 days past due and was not classified as delinquent or placed on non-accrual status as the loan is well collateralized and the Company expects to receive the principal and interest due.

As of December 31, 2009, the Company had impaired loans with an aggregate outstanding balance of \$352.4 million. Impaired loans with an aggregate outstanding balance of \$257.7 million have been restructured and classified as TDRs. Impaired loans with an aggregate outstanding balance of \$162.7 million were also on non-accrual status. During 2009, the Company recorded \$132.5 million of specific provisions for impaired loans. At December 31, 2009, the Company had a \$75.4 million specific allowance for impaired loans with an aggregate outstanding balance of \$306.5 million. At December 31, 2009, additional funding commitments for impaired loans totaled \$27.8 million. As of December 31, 2009, impaired loans with an aggregate outstanding balance of \$123.9 million were greater than 60 days past due and classified as delinquent by the Company. Included in the \$75.4 million specific allowance for impaired loans was \$24.9 million related to delinquent loans.

During the three and six months ended June 30, 2010, the aggregate average balance of impaired loans was \$375.5 million and \$400.3 million, respectively. The total amount of interest income recognized during the three and six months ended June 30, 2010 from impaired loans was \$3.2 million and \$6.6 million, respectively. The amount of cash basis interest income that was recognized for the three and six months ended



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June 30, 2010 was \$2.3 million and \$5.4 million, respectively.

During the three and six months ended June 30, 2009, the aggregate average balance of impaired loans was \$278.5 million and \$286.8 million, respectively. The total amount of interest income recognized during the three and six months ended June 30, 2009 from impaired loans was \$2.8 million and \$5.9 million, respectively. The amount of cash basis interest income that was recognized for the three and six months ended June 30, 2009 was \$2.2 million and \$5.2 million, respectively.

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

	<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(\$ in thousands)</b>	
Balance, beginning of year	\$ 114,470	\$ 53,977
Provision for credit losses - general	(3,944)	2,324
Provision for credit losses - specific	36,533	59,160
Loans charged off, net of recoveries	(46,330)	(24,121)
Loans charged off upon transfer to held-for-sale net of recoveries		(5,000)
Balance, end of period	\$ 100,729	\$ 86,340

During the six months ended June 30, 2010 the Company recorded a total provision for credit losses of \$32.6 million. The Company decreased its allowance for credit losses to \$100.7 million at June 30, 2010 from \$114.5 million at December 31, 2009. This decrease in allowance for credit losses resulted primarily from impaired loans charged off during the six months ended June 30, 2010, the \$178.6 million decrease in total loans net as compared to December 31, 2009, and the increase of commercial real estate loans with a specific allowance for credit losses. The general allowance for credit losses covers probable losses in the Company's loan portfolio with respect to loans for which no specific impairment has been identified. The general allowance for credit losses decreased as negative credit migration slowed and general economic conditions improved. 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, net increased to 20% as of June 30, 2010 as compared to 18% as of December 31, 2009 and 12% as of June 30, 2009. In accordance with ASC 310 (formerly SFAS No. 114, Accounting by Creditors for Impairment of a Loan), 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 is closely monitoring the credit quality of its loans and loan delinquencies, non-accruals and charge offs, and the occurrence of these events may increase due to economic conditions and seasoning of the loan portfolio.

Included in the allowance for credit losses at June 30, 2010 and December 31, 2009 is an allowance for unfunded commitments of \$0.8 million and \$0.6 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 losses.

Based on the Company's evaluation process to determine the level of the allowance for loan losses, management believes the allowance to be adequate as of June 30, 2010 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 second quarter of 2009, the Company adjusted its allowance for credit losses methodology regarding commercial real estate to reflect deteriorating market conditions, which has increased the probability of default for borrowers with high loan to value ratios. If the Company determines that additional changes in its allowance for credit losses methodology are advisable, as a result of the rapidly changing economic environment or otherwise, the revised allowance methodology may result in higher 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.

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During 2009, as part of the resolution of two impaired commercial real estate loans, the Company took control of the underlying commercial real estate properties. During the three months ended June 30, 2010, the Company sold one of these commercial real estate properties. At June 30, 2010, the remaining asset had a carrying amount of \$3.4 million and was classified as other real estate owned ( OREO ) and included in Other assets in the Company s balance sheet.

During the three months ended June 30, 2009, the Company sold an asset which was classified as other real estate owned as a result of a foreclosure on an impaired real estate loan. During the three and six months ended June 30, 2009, the Company recorded a loss of \$1.9 million and \$3.2 million, respectively, related to this asset to reflect its net fair value.

**Table of Contents****NEWSTAR FINANCIAL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Unaudited****Note 5. Restricted Cash**

Restricted cash as of June 30, 2010 and December 31, 2009 was as follows:

	June 30, 2010	December 31, 2009
	(\$ in thousands)	
Collections on loans pledged to credit facilities	\$ 15,518	\$ 21,727
Principal and interest collections on loans held in trust and prefunding amounts	122,648	105,812
Customer escrow accounts	8,482	9,345
Total	\$ 146,648	\$ 136,884

As of June 30, 2010, the Company had the ability to use \$27.4 million of restricted cash to fund new or existing loans.

**Note 6. Investments in Debt Securities, Available-for-Sale**

Amortized cost of investments in debt securities as of June 30, 2010 and December 31, 2009 was as follows:

	June 30, 2010	December 31, 2009
	(\$ in thousands)	
Investments in debt securities - gross	\$ 6,552	\$ 6,635
Unamortized discount	(2,298)	(2,298)
Investments in debt securities - amortized cost	\$ 4,254	\$ 4,337

The amortized cost, gross unrealized holding gains, gross unrealized holding losses, and fair value of available-for-sale securities at June 30, 2010 and December 31, 2009 were as follows:

	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
	(\$ in thousands)			
June 30, 2010:				
Other debt obligation(1)	\$ 4,254	\$	\$ (232)	\$ 4,022