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

FORM 10-K

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

For the Fiscal Year Ended December 31, 2017

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 000-22897

NOVATION COMPANIES, INC.
(Exact Name of Registrant as Specified in its Charter)

Maryland

(State or Other Jurisdiction of Incorporation or Organization)

74-2830661

(I.R.S. Employer Identification No.)

500 Grand Boulevard, Suite 201B, Kansas City, MO

(Address of Principal Executive Office)

64106

(Zip Code)

Registrant's Telephone Number, Including Area Code: (816) 237-7000

Securities Registered Pursuant to Section 12(b) of the Act:
None

Securities Registered Pursuant to Section 12(g) of the Act:
Title of Each Class
Common Stock, \$0.01 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of voting and non-voting stock held by non-affiliates of the registrant as of June 30, 2017 was approximately \$8,117,000, based upon the closing sales price of the registrant's common stock on that date (\$0.14).

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

The number of shares of the registrant's common stock outstanding on April 9, 2018 was 96,007,321.

NOVATION COMPANIES, INC.
FORM 10-K
For the Fiscal Year ended December 31, 2017

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PART I

Unless the context otherwise requires, references in this Annual Report on Form 10-K to “Novation,” the “Company,” “NOVC,” “we,” “us” and “our,” refer to Novation Companies, Inc. and its consolidated subsidiaries and their respective predecessors.

Forward-Looking Statements

Statements in this report regarding Novation and its business that are not historical facts are “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements are those that predict or describe future events, do not relate solely to historical matters and include statements regarding management’s beliefs, estimates, projections, and assumptions with respect to, among other things, our future operations, business plans and strategies, as well as industry and market conditions, all of which are subject to change at any time without notice. Words such as “believe,” “expect,” “anticipate,” “promise,” “plan,” and other expressions or words of similar meanings, as well as future or conditional auxiliary verbs such as “would,” “should,” “could,” or “may” are generally intended to identify forward-looking statements. Risks, uncertainties, contingencies, and developments, including those discussed in “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this report could cause our future operating results to differ materially from those set forth in any forward-looking statement. Given these uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. We disclaim any obligation to update any such factors or to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future results, events or developments.

Item 1. Business

Overview

Through Healthcare Staffing, Inc. (“HCS”), our wholly-owned subsidiary acquired on July 27, 2017, we provide outsourced health care staffing and related services in the State of Georgia. We also own a portfolio of mortgage securities which generate earnings to support on-going financial obligations. Our common stock, par value \$0.01 per share, is traded on the OTC Pink marketplace of the OTC Markets Group, Inc. under the symbol “NOVC”.

Recent Developments

Emergence from Bankruptcy. On July 20, 2016 (the “Bankruptcy Petition Date”), Novation and three of its subsidiaries, NovaStar Mortgage LLC (“NMLLC”), NovaStar Mortgage Funding Corporation and 2114 Central LLC (the “Debtors”), filed voluntary petitions (the “Bankruptcy Petitions”) for reorganization under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Maryland (the “Bankruptcy Court”). The Company and one of its subsidiaries subsequently filed with the Bankruptcy Court and amended a plan of reorganization (the “Plan”) and a related disclosure statement. The Bankruptcy Court entered an order on June 12, 2017 confirming the Plan (the “Confirmation Order”) solely with respect to the Company. On July 27, 2017, upon the completion of the HCS Acquisition and the Note Refinancing (each as defined below), and the satisfaction or waiver of all other conditions precedent to effectiveness, the effective date of the Plan occurred and the Company filed a Notice of Occurrence of Effective Date of the Plan with the Bankruptcy Court. Under the Plan, holders of existing equity interests in the Company (i.e., the common stock) retain their interests.

On September 25, 2017, the bankruptcy case of 2114 Central, LLC was dismissed by order of the Bankruptcy Court. Thereafter, on December 22, 2017, NMLLC filed with the Bankruptcy Court a Chapter 11 plan of reorganization, and on December 26, 2017 filed a related disclosure statement. The Bankruptcy Court entered an order on February 16, 2018 approving the disclosure statement, as revised. The Bankruptcy Court will conduct a hearing on April 11, 2018 to consider confirmation of NMLLC’s plan of reorganization.

Acquisition of Healthcare Staffing, Inc. On July 27, 2017, the Company acquired all of the outstanding capital stock of HCS from Butler America, LLC (“Butler”) for approximately \$24.0 million in cash (the “HCS Acquisition”), pursuant to the terms and conditions of a Stock Purchase Agreement, dated as of February 1, 2017 (as amended, the “HCS Purchase Agreement”), by and among the Company, Novation Holding, Inc., a wholly-owned subsidiary of the Company (“NHI”), HCS and Butler. The purchase price is subject to adjustment as provided in the HCS Purchase Agreement. See Note 4 to the consolidated financial statements for additional information regarding the HCS Acquisition. The operations of HCS are the Company’s primary operations.

Note Refinancing. On July 27, 2017, the Company entered into a Senior Secured Note Purchase Agreement, dated as of the same date (the “Note Purchase Agreement”), with NHI and HCS as guarantors (together with the Company, collectively, the “Credit Parties”), Taberna Preferred Funding I, Ltd. (“Taberna I”), Taberna Preferred Funding II, Ltd. (“Taberna II”) and Kodiak CDO I, Ltd. (“Kodiak” and, together with Taberna I and Taberna II, the “Noteholders”) and Wilmington Savings Fund Society, FSB, as collateral agent for the benefit of the Noteholders, to refinance \$85,937,500 of principal indebtedness of the Company under the Company’s senior notes (collectively, the “2011 Notes”) held by the Noteholders, issued pursuant to three Indentures, each dated as of March 22, 2011 (the “Note Refinancing”). Pursuant to the Note Purchase Agreement, the Noteholders exchanged their 2011 Notes for new notes from the Company in the same aggregate principal amount (collectively, the “2017 Notes”) on the terms and conditions set forth therein. The unpaid principal amounts of the 2017 Notes bear interest at a variable rate equal to LIBOR plus 3.5% per annum, payable quarterly in arrears until maturity on March 30, 2033. The 2017 Notes

generally rank senior in right of payment to any existing or future subordinated indebtedness of the Credit Parties. See Notes 2 and 8 to the consolidated financial statements for additional information regarding the Note Refinancing.

Business

Our business includes the operation of HCS and the management of our other investments, as described below.

HCS

Established in 1995, HCS is the largest outsourced healthcare services provider in the State of Georgia. HCS delivers outsourced full-time and part-time employees primarily to Community Service Boards (“CSB”). A CSB is a quasi-state organization providing behavioral health services at facilities across Georgia including mental health services, developmental disabilities programs and substance abuse treatments. The State of Georgia has a total of 25 CSB. Each CSB has a number of facilities, including crisis centers, outpatient centers and 24-hour group homes that require a broad range of employees, such as registered nurses, social workers, house parents and supervisors. The CSB market in Georgia is large and growing steadily, as the demand for the services provided by the CSB continues to grow. The Georgia Association for CSB estimates that CSB in Georgia provided services to more than 173,000 people in 2010, a figure that grew to more than 188,000 people in 2016. In addition to providing outsourced employees to CSB, HCS also provides healthcare outsourcing and staffing services to hospitals, schools, crisis units, clinics, doctors offices, prisons and a variety of privately owned businesses.

Over the past 15 years, HCS has become the largest medical services outsource provider in Georgia, operating throughout the state. HCS has long-term relationships with its customers and has been providing services to several clients for more than 15 years. The services and positions provided to non-CSB clients are similar to the ones provided to CSB client.

Other Investments

Prior to 2016, the Company originated, purchased, securitized, sold, invested in and serviced residential nonconforming mortgage loans and mortgage securities. As a result of those activities, we acquired mortgage securities that continue to be a source of our earnings and cash flow. Residual securities consist of interest-only and overcollateralization bonds. Collectively, these securities are referred to as our retained mortgage securities.

Strategy

The strategy of HCS is to continue expanding its market share in providing healthcare staffing services in Georgia and in particular serving Georgia CSBs. HCS is the dominant player in providing services to Georgia CSBs and has earned a market share of 55% of the CSB business. HCS will also continue to expand business to additional hospitals, private group homes, clinics, rest homes, prisons and retirement centers. Furthermore, the HCS strategy includes expanding clerical staff within existing customers, as well as gaining new clients. The longer-term strategy includes expansion beyond the Georgia market and may include acquisitions of staffing companies outside of Georgia, particularly in states that have public health infrastructure similar to that of Georgia.

We expect to use profits from HCS along with, potentially, other funding sources to acquire other businesses or make investments.

Competition

HCS competes with numerous national staffing and recruiting businesses that specialize in the medical and healthcare industry, such as Nursefinders, Lighthouse Recruiting, Action Med and Brightstar. Other national staffing businesses have divisions that compete with HCS in Georgia, including Kelly Services, Interim, Randstad and Maxim. Numerous Georgia non-national and smaller staffing providers also compete with HCS.

Regulation

The healthcare industry is subject to extensive and complex federal, state and local laws and regulations related to, among other things, conduct of operations, and costs and payment for services. HCS is not directly regulated as a healthcare provider, although the customers of HCS are highly regulated. Therefore, HCS complies with many of the regulations prescribed for its customers.

HCS provides services directly to its clients on a contract basis and receives payment directly from them. However, many clients are reimbursed under the federal Medicare program and state Medicaid programs for the services they provide. Therefore, HCS also may be affected indirectly by reimbursement changes in government programs, particularly Medicare and Medicaid.

Employees

As of April 9, 2018, the Company employed 1,798 full-time employees and 201 part-time employees. None of the Company's employees are represented by a union or covered by a collective bargaining agreement.

Additional Information

The Company is a Maryland corporation formed on September 13, 1996 as "CapStar Financial, Inc." The Company's name was changed to "NovaStar Financial, Inc." effective October 11, 1996, and to "Novation Companies, Inc." effective May 23, 2012. Our corporate executive offices are located at 500 Grand Boulevard, Suite 201B, Kansas City, MO 64106 and our telephone number is (816) 237-7000. Our website address is www.novationcompanies.com. Our website is not intended to be a part of, nor are we incorporating it by reference into, this Annual Report on Form 10-K (this "Form 10-K"). Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act are available, free of charge, on our website as soon as reasonably practicable after we electronically file this material with, or furnish it to, the SEC. Reports and other information we file with the SEC may also be viewed at the SEC's website at www.sec.gov or viewed or obtained at the SEC Public Reference Room at 100 F Street, N.E., Washington, DC 20549.

Item 1A. Risk Factors

Investing in our common stock involves a high degree of risk. You should carefully consider the following risk factors, as well as the other information contained in this Form 10-K, including our consolidated financial statements and notes thereto, before deciding whether to invest in our common stock. Any of these risks, as well as additional risks and uncertainties that we are unaware of, could negatively affect our results of operations, financial condition, liquidity and business prospects, and cause the trading price of our common stock to decline, and cause you to lose all or part of your investment.

Risks Related to our Business and Industry

The healthcare industry is highly regulated.

The healthcare industry is subject to extensive and complex federal, state and local laws and regulations related to, among other things, conduct of operations, and costs and payment for services. While HCS is not directly regulated as a healthcare provider, the customers of HCS are highly regulated. Therefore, HCS must comply with many of the regulations prescribed for its customers. If HCS does not comply with applicable laws and regulations, it could incur civil and/or criminal penalties as well as litigation or be subject to equitable remedies. HCS may lose customers if it cannot adequately adhere to the regulations.

HCS provides services to hospitals and health systems that pay HCS directly. Accordingly, Medicare, Medicaid and insurance reimbursement policy changes generally do not directly impact HCS. However, HCS's business, financial condition and results of operations depend upon conditions affecting the healthcare industry generally and hospitals and health systems particularly. The healthcare industry is highly regulated and is subject to changing political, economic and regulatory influences. Factors such as changes in reimbursement policies for healthcare expenses, consolidation in the healthcare industry, regulation, litigation and general economic conditions affect the purchasing practices, operations and the financial health of HCS's customers.

Reimbursement changes in government programs, particularly Medicare and Medicaid, can and do indirectly affect the demand and the prices paid for HCS's services. For example, HCS clients could receive reduced or no reimbursements because of a change in the rates or conditions set by the government, which would negatively affect the demand and the prices for HCS's services.

The business of HCS is concentrated in the State of Georgia and to a relatively few number of customers.

HCS derives all of its revenues from clients in the State of Georgia. As a result, HCS is subject to risks associated with conditions in the State of Georgia, including but not limited to economic and regulatory risks, than healthcare staffing and other companies that are more geographically diversified.

HCS derives the majority of its businesses from CSBs. There are 25 CSBs in Georgia and HCS conducts business with 14 of them. Matters that adversely impact Georgia CSBs, including regulatory changes, may negatively affect our business.

Our clients may terminate or not renew their contracts with us.

Our arrangements with CSBs and other customers generally are terminable upon 60 days' notice for any reason. The loss of one or more of our large customers could materially affect our profitability.

We may be unable to recruit enough healthcare professionals to meet our clients' demands.

HCS relies significantly on its ability to attract, develop and retain healthcare professionals who possess the skills, experience and, as required, licensure necessary to meet the specified requirements of our healthcare clients. The ability to recruit

healthcare professionals generally and the competition for their services may limit our ability to increase the number of healthcare professionals that we successfully recruit, decreasing our ability to grow our business.

We are subject to litigation in the ordinary course of business, which could result in substantial judgment or settlement costs; significant legal actions could subject us to substantial uninsured liabilities.

HCS is a party to various litigation claims and legal proceedings in its normal course of business. We evaluate these litigation claims and legal proceedings to assess the likelihood of unfavorable outcomes and to estimate, if possible, the amount of potential losses. We may not have sufficient insurance to cover these risks. Actual outcomes or losses may differ materially from those estimated by our current assessments which would impact our profitability. Adverse developments in existing litigation claims or legal proceedings involving HCS or new claims could require us to establish litigation reserves, enter into unfavorable settlements or satisfy judgments for monetary damages for amounts in excess of current reserves, which could adversely affect our financial results. We may not have sufficient insurance to cover these risks. Litigation losses would impact our profitability.

Our collection, use, and retention of personal information and personal health information create risks that may harm our business.

As part of its business model, HCS collects, transmits and retains personal information of our employees and contract professionals and their dependents, including, without limitation, full names, social security numbers, addresses, birth dates, and payroll-related information. Employees or third parties may be able to circumvent security measures in place and acquire or misuse such information, resulting in breaches of privacy, and errors in the storage, use or transmission of such information may result in breaches of privacy. We may be required to incur significant expenses to comply with mandatory privacy and security standards and protocols imposed by law, regulation, industry standards, or contractual obligations if a privacy breach were to occur.

Cyber security risks and cyber incidents could adversely affect our business and disrupt operations.

Cyber incidents can result from deliberate attacks or unintentional events. These incidents can include, but are not limited to, gaining unauthorized access to digital systems for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. The result of these incidents could include, but are not limited to, disrupted operations, misstated financial data, liability for stolen assets or information, increased cyber security protection costs, litigation and reputational damage adversely affecting customer or investor confidence. Security measures in place may not provide absolute security, and systems may be vulnerable to cyber-security breaches such as viruses, hacking, and similar disruptions from unauthorized intrusions. In addition, third party service providers perform certain services, such as payroll and tax services. Any failure of HCS or third party systems may compromise sensitive information and/or personally identifiable information of employees.

Risks Related to our Company

We have a history of operating losses and we may not generate sufficient revenue to support our operations.

During 2017, we incurred a net loss of \$10.9 million and generated negative operating cashflow of \$8.7 million. As of December 31, 2017, we had an overall shareholders deficit of \$57.9 million. As of December 31, 2017, we had an aggregate of \$2.7 million in cash and cash equivalents and total liabilities of \$97.7 million. Of the \$2.7 million in cash, \$1.1 million was held by our subsidiary NMLLC, which has filed a Chapter 11 plan of reorganization that remains subject to court approval. This cash is not available to pay general creditors of NMLLC. The Company also has a significant on-going obligation to pay interest under its senior note agreement. In addition, beginning in 2018 a significant customer significantly reduced the level of staff outsourced to HCS.

At the time of the Company's filing of its Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, management concluded that substantial doubt existed about the Company's ability to continue as a going concern within one year after the date that the consolidated financial statements were issued. Management's assessment was based on the expected negative impact on cash flow related to the loss of a significant customer of HCS. In addition, management was unsure of its ability to generate cash flow through other means, such as selling the Company's marketable securities at acceptable prices and uncertainty as to whether the Company could efficiently transfer the securities and receive cash proceeds in order to meet obligations as they come due.

Subsequent to that filing and subsequent to year end, the Company engaged a major investment firm to evaluate the marketplace for its mortgage securities. Management learned during that process that a market exists for the Company's mortgage securities and that those securities may be sold at prices acceptable to the Company. The Company executed trades to sell a portion of its overcollateralization mortgage securities. These sales are expected to generate \$2.9 million in cash proceeds for the Company. Management believes that other mortgage securities may be sold on similar terms in the event additional cash proceeds are needed. In addition, through the date of this filing, HCS has demonstrated that it can provide

positive cash flow sufficient to support HCS operations. Management continues to work toward expanding HCS's customer base by increasing revenue from existing customers and targeting new customers that have not previously been served by HCS. In addition, management is exploring cost cutting initiatives that will reduce overall corporate overhead and operating costs.

While our historical operating results and poor cashflow suggest substantial doubt exists related to the Company's ability to continue as a going concern, management has concluded that the factors discussed above have alleviated the substantial doubt about the Company's ability to continue as a going concern within one year after the date that these consolidated financial statements are issued.

We cannot provide assurance that revenue generated from our businesses will be sufficient to sustain our operations in the long term. Additionally, we cannot be certain that we will be successful at raising capital, whether from divesting of mortgage securities or other assets, or from equity or debt financing, on commercially reasonable terms, if at all. Such failures would have a material adverse effect on our business, including the possible cessation of operations.

We found material weaknesses in our disclosure controls and procedures and internal control over financial reporting and concluded that they were not effective as of December 31, 2017.

As disclosed in Part II, Item 9. Controls and Procedures of this Form 10-K, our executive chairman and chief financial officer, with the participation of the Company's management, concluded that our disclosure controls and procedures and internal controls over financial reporting were not effective as of December 31, 2017 due to the lack of adequate processes, procedures and controls at HCS. Our failure to successfully remediate these material weaknesses could cause us to fail to meet our reporting obligations and to produce timely and reliable financial information. Additionally, such failure could cause investors to lose confidence in our public disclosures, which could have a negative impact on our stock price. For a discussion of these material weaknesses and our remediation efforts, please see Part II, Item 9. Controls and Procedures of this Form 10-K.

Our ability to use our net operating loss carryforwards and net unrealized built-in losses could be severely limited.

As of December 31, 2017, we had federal net operating losses ("NOLs") of approximately \$692.0 million, including \$307.3 million in losses on mortgage securities that have not been recognized for income tax purposes. Our ability to use NOLs to offset future taxable income will depend on the amount of taxable income we generate in future periods and whether we become subject to annual limitations on the amount of taxable income that may be offset by our NOLs.

Section 382 of the Internal Revenue Code of 1986, as amended (the "Code"), imposes an annual limitation on the amount of taxable income that may be offset by a corporation's NOLs if the corporation experiences an "ownership change" as defined in Section 382 of the Code. An ownership change occurs when the corporation's "5-percent shareholders" (as defined in Section 382 of the Code) collectively increase their ownership in the corporation by more than 50 percentage points (by value) over a rolling three-year period. Additionally, various states have similar limitations on the use of state NOLs following an ownership change.

Our charter includes provisions designed to protect the tax benefits of our NOLs by generally restricting any direct or indirect transfers of our common stock that increase the direct or indirect ownership of our common stock by any person from less than 4.99% to 4.99% or more, or increase the percentage of our common stock owned directly or indirectly by a person owning or deemed to own 4.99% or more of our common stock. Any direct or indirect transfer attempted in violation of these transfer restrictions will be void as of the date of the prohibited transfer as to the purported transferee. These transfer restrictions expire on August 1, 2020. Additionally, we have adopted and our shareholders have approved a Rights Agreement (the "NOL Rights Plan") that generally is designed to deter any person from acquiring shares of our common stock if the acquisition would result in such person beneficially owning 4.99% or more of our common stock without the approval of our Board of Directors (the "Board"). Our NOL Rights Plan expires on July 23, 2018. We intend to ask the shareholders to vote to extend the NOL Rights Plan at the Company's next annual meeting of shareholders.

Although these measures are intended to reduce the likelihood of an ownership change, we cannot assure you that they will prevent all transfers of our common stock that could result in such an ownership change. Further, these measures could make it more difficult for a third party to acquire, or could discourage a third party from acquiring, the Company or a large block of our common stock, which may adversely affect the marketability, and depress the market price, of our common stock. In addition, these provisions could delay or frustrate the removal of incumbent directors and could make more difficult a merger, tender offer or proxy contest involving us, or impede an attempt to acquire a significant or controlling interest in us, even if such events might be beneficial to us and our shareholders.

On December 22, 2017, the President signed into law the Tax Cuts and Jobs Act ("2017 Tax Act"), which contains substantial changes to the Code. The 2017 Tax Act, among other things, reduces the federal corporate tax rate from a top marginal rate of 35% to a flat rate of 21%, limits the tax deduction for interest expense to 30% of adjusted earnings, eliminates NOL carrybacks, limits the deductibility of loss carryforwards to 80% of current-year taxable income, and modifies or repeals many business deductions and credits. The tax rate reduction took effect on January 1, 2018. The lower tax rate and other new limits on the recognition of tax loss carryforwards have also reduced the value of existing NOL carryforwards and other tax assets. See Note 12 to our consolidated financial statements. There was no net effect of the tax reform enactment on the consolidated financial

statements as of December 31, 2017. Notwithstanding the reduction in the corporate income tax rate, the overall impact of the Tax Act is uncertain and our business and financial condition could be adversely affected. We continue to examine the impact these changes may have on our deferred tax assets and our business.

Covenant restrictions under our indebtedness may limit our ability to operate our business.

The agreement governing the 2017 Notes contains, among other things, covenants that may restrict our and our subsidiaries' ability to finance future operations, capital needs or to engage in other business activities. The Note Purchase Agreement and the 2017 Notes limit our ability and the ability of our subsidiaries to take certain actions without the consent of the Noteholders, including but not limited to the following:

- incur indebtedness;
- create certain liens;
- make payments to our shareholders;
- acquire our outstanding shares, or the shares of our subsidiaries;
- make payments on debt securities junior to the 2017 Notes; and
- merge, consolidate, transfer and/or sell substantially all of our assets.

There can be no assurance that we will be able to receive the consent of the Noteholders should we have a need to take one of the restricted actions, which limitation may hinder our ability to operate or grow our business in the future.

Loss of key members of our management could disrupt our business.

The loss of key members of management could have a material adverse effect on our business, financial condition and results of operations. We may not be able to retain our existing senior management, fill new positions or vacancies created by expansion or turnover or attract additional qualified senior management personnel.

Differences in our actual experience compared to the assumptions that we use to determine the value of our residual mortgage securities and to estimate fair values could further adversely affect our financial position.

The Company uses significant unobservable inputs (Level 3 inputs) to estimate the fair value of its residual mortgage securities. Material differences between actual experience and the assumptions used to determine the fair value of these securities may negatively impact our financial condition and results of operations. For example, one significant unobservable input used to determine the fair value of the Company's residual mortgage securities is the prepayment rate for the underlying mortgage loan collateral. If prepayment rates are faster (higher) than our estimates, the value of the securities may decline significantly.

The cash flows from, and value of, our mortgage securities will further decline as the underlying mortgage loan collateral declines.

There are many factors that affect the cash flows from, and value of, our mortgage securities, many of which are beyond our control. In general, the nature of mortgage securities is that as the underlying mortgage loan collateral is repaid or defaults, the cash flows from, and value of, our securities will decline.

We may be required to repurchase mortgage loans or indemnify mortgage loan purchasers as a result of breaches of representations and warranties, borrower fraud, or certain borrower defaults, which could further harm our liquidity.

When we sold mortgage loans, whether as whole loans or pursuant to a securitization, we made customary representations and warranties to the purchaser about the mortgage loans and the manner in which they were originated. Our whole loan sale agreements require us to repurchase or substitute mortgage loans in the event we breach any of these representations or warranties. In addition, we may be required to repurchase mortgage loans as a result of borrower, broker, or employee fraud. Likewise, we are required to repurchase or substitute mortgage loans if we breach a representation or warranty in connection with our securitizations. We have received various repurchase demands as performance of subprime mortgage loans has deteriorated. A majority of repurchase requests have been denied, otherwise a negotiated purchase price adjustment was agreed upon with the purchaser. Enforcement of repurchase obligations against us would further harm our liquidity.

Risks Related to our Capital Stock

There can be no assurance that our common stock will continue to be traded in an active market.

Our common stock currently trades on the OTC Pink marketplace of the OTC Markets Group, Inc. Trading of securities on this quotation service is generally limited and is effected on a less regular basis than on exchanges, such as the NYSE, and accordingly investors who own or purchase our stock will find that the liquidity or transferability of the stock may be limited. Additionally, a shareholder may find it more difficult to dispose of, or obtain accurate quotations as to the market value of, our stock. If an active public trading market cannot be sustained, the trading price of our common stock could be adversely affected and the ability of an investor to transfer their shares of our common stock may be limited.

The market price and trading volume of our common stock may be volatile, which could result in substantial losses for our shareholders.

The market price of our capital stock can be highly volatile and subject to wide fluctuations. In addition, the trading volume in our capital stock may fluctuate and cause significant price variations to occur. Investors may experience volatile returns and material losses. Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our capital stock include:

- actual or anticipated changes in our earnings and cash flow;
- general market and economic conditions, including the operations and stock performance of other industry participants;
- the impact of new state or federal legislation or adverse court decisions;
- actual or anticipated changes in the delinquency and default rates on mortgage loans, in general, and specifically on the loans we invest in through our mortgage securities;
- actual or anticipated changes in financial estimates by securities analysts;
- sales, or the perception that sales could occur, of a substantial number of shares of our common stock by insiders;
- additions or departures of senior management and key personnel; and
- actions by institutional shareholders.

Some provisions of our charter, bylaws, Maryland law and our NOL Rights Plan may deter takeover attempts, which may limit the opportunity of our shareholders to sell their common stock at favorable prices.

Certain provisions of our charter, bylaws, Maryland law, and our NOL Rights Plan could discourage, delay or prevent transactions that involve an actual or threatened change in control, and may make it more difficult for a third party to acquire us, even if doing so may be beneficial to our shareholders. Under our charter, generally a director may only be removed for cause and only by the affirmative vote of the holders of at least a majority of all classes of shares entitled to vote in the election for directors together as a single class. Maryland law provides protection for Maryland corporations against unsolicited takeover situations. Further, our charter includes provisions designed to protect the tax benefits of our NOLs by generally restricting any direct or indirect transfers of our common stock that increase the direct or indirect ownership of our common stock by any person from less than 4.99% to 4.99% or more, or increase the percentage of our common stock owned directly or indirectly by a person owning or deemed to own 4.99% or more of our common stock. Any direct or indirect transfer attempted in violation of these transfer restrictions will be void as of the date of the prohibited transfer as to the purported transferee. These transfer restrictions expire on August 1, 2020. Additionally, we have adopted an NOL Rights Plan that generally is designed to deter any person from acquiring shares of our common stock if the acquisition would result in such person beneficially owning 4.99% or more of our common stock without the approval of our Board. Our NOL Rights Plan expires on July 23, 2018. We intend to ask the shareholders to vote to extend the NOL Rights Plan at the Company's next annual meeting of shareholders.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The executive and administrative offices for the Company are located in Kansas City, Missouri, and consist of approximately 2,300 square feet of leased office space. HCS leases office space in a number of locations in the state of Georgia. The executive and administrative offices for HCS are located in College Park, Georgia, and consist of approximately 4,700 square feet of leased office space.

Item 3. Legal Proceedings

The Company is a party to various legal proceedings. Except as set forth below, these proceedings are of an ordinary and routine nature.

On May 21, 2008, a purported class action case was filed in the Supreme Court of the State of New York, New York County, by the New Jersey Carpenters' Health Fund, on behalf of itself and all others similarly situated. Defendants in the case included NovaStar Mortgage Funding Corporation ("NMFC") and NovaStar Mortgage, Inc. ("NMI"), wholly-owned subsidiaries of the Company, and NMFC's individual directors, several securitization trusts sponsored by the Company ("affiliated defendants") and several unaffiliated investment banks and credit rating agencies. The case was removed to the United States District Court for the Southern District of New York. On June 16, 2009, the plaintiff filed an amended complaint. The plaintiff seeks monetary damages, alleging that the defendants violated sections 11, 12 and 15 of the Securities Act of 1933, as amended, by making allegedly false statements regarding mortgage loans that served as collateral for securities purchased by the plaintiff and the purported class members. On August 31, 2009, the Company filed a motion to dismiss the plaintiff's claims, which the court granted on March 31, 2011, with leave to amend. The plaintiff filed a second amended complaint on May 16, 2011, and the Company again filed a motion to dismiss. On March 29, 2012, the court dismissed the plaintiff's second amended complaint with prejudice and without leave to replead. The plaintiff filed an appeal. On March 1, 2013, the appellate court reversed the judgment of the lower court, which had dismissed the case. Also, the appellate court vacated the judgment of the lower court which had

held that the plaintiff lacked standing, even as a class representative, to sue on behalf of investors in securities in which plaintiff had not invested, and the appellate court remanded the case back to the lower court for further proceedings. On April 23, 2013 the plaintiff filed its memorandum with the lower court seeking a reconsideration of the earlier dismissal of plaintiff's claims as to five offerings in which plaintiff was not invested, and on February 5, 2015 the lower court granted plaintiff's motion for reconsideration and vacated its earlier dismissal. On March 8, 2017, the affiliated defendants and all other parties executed an agreement to settle the action, with the contribution of the affiliated defendants to the settlement fund being paid by their insurance carriers. The court certified a settlement class and granted preliminary approval to the settlement on May 10, 2017. One member of the settlement class objected to the settlement and sought a stay of the final settlement approval hearing on the ground that it did not receive notice of the settlement and had no opportunity to timely opt out of the class. After the court rejected the motion for a stay, the objector filed an appeal and requested a stay of the district court proceedings pending disposition of the appeal. The court of appeals denied the temporary stay of the district court proceedings pending a decision on the objector's request for a stay. Assuming the settlement is approved and completed, the Company will incur no loss. The Company believes that the affiliated defendants have meritorious defenses to the case and, if the settlement is not approved, expects them to defend the case vigorously.

On June 20, 2011, the National Credit Union Administration Board, as liquidating agent of U.S. Central Federal Credit Union, filed an action against NMFC and numerous other defendants in the United States District Court for the District of Kansas, claiming that the defendants issued or underwrote residential mortgage-backed securities pursuant to allegedly false or misleading registration statements, prospectuses, and/or prospectus supplements. On August 24, 2012, the plaintiff filed an amended complaint making essentially the same claims against NMFC. NMFC filed a motion to dismiss the amended complaint which was denied on September 12, 2013. The defendants had claimed that the case should be dismissed based upon a statute of limitations and sought an appeal of the court's denial of this defense. An interlocutory appeal of this issue was allowed, and on August 27, 2013, the Tenth Circuit affirmed the lower court's denial of defendants' motion to dismiss the plaintiff's claims as being time barred; the appellate court held that the Extender Statute, 12 U.S.C. §1787(b)(14) applied to plaintiff's claims. On June 16, 2014, the United States Supreme Court granted a petition of NMFC and its co-defendants for certiorari, vacated the ruling of the Tenth Circuit, and remanded the case back to that court for further consideration in light of the Supreme Court's decision in *CTS Corp. v. Waldburger*, 134 S. Ct. 2175 (2014). On August 19, 2014, the Tenth Circuit reaffirmed its prior decision, and on October 2, 2014 the defendants filed a petition for writ of certiorari with the Supreme Court, which was denied. On March 22, 2016, NMFC filed motions for summary judgment, and plaintiff filed a motion for partial summary judgment. Those motions remain pending. Given that plaintiff did not file a timely proof of claim in NMFC's bankruptcy case, the Company believes it is likely that the case will be dismissed. The Company believes that NMFC has meritorious defenses to the case and expects it to defend the case vigorously in the event it proceeds.

On February 28, 2013 the Federal Housing Finance Agency, as conservator for the Federal Home Loan Mortgage Corporation (Freddie Mac) and purportedly on behalf of the Trustee of the NovaStar Mortgage Funding Trust, Series 2007-1 (the "Trust"), a securitization trust in which the Company retains a residual interest, filed a summons with notice in the Supreme Court of the State of New York, County of New York against the Company and NMI. The notice provides that this is a breach of contract action with respect to certain, unspecified mortgage loans and defendants' failure to repurchase such loans under the applicable agreements. Plaintiff alleges that defendants, from the closing date of the transaction that created the Trust, were aware of the breach of the representations and warranties made and failed to give notice of and cure such breaches, and due to the failure of defendants to cure any breach, notice to defendants would have been futile. The summons with notice was not served until June 28, 2013. By letter dated June 24, 2013, the Trustee of the Trust forwarded a notice from Freddie Mac alleging breaches of representations and warranties with respect to 43 loans, as more fully set forth in included documentation. The 43 loans had an aggregate, original principal balance of about \$6.5 million. On August 19, 2013, Deutsche Bank National Trust Company, as Trustee, filed a complaint identifying alleged breaches of representations and warranties with respect to seven loans that were included in the earlier list of 43 loans. Plaintiff also generally alleged a trust-wide breach of representations and warranties by defendants with respect to loans sold and transferred to the trust. Plaintiff seeks specific performance of repurchase obligations; compensatory, consequential, recessionary and equitable damages for breach of contract; specific performance and damages for anticipatory breach of contract; indemnification (indemnification against NMI only) and damages for breach of the implied covenant of good faith and fair dealing. On October 9, 2013, the Company and NMI filed a motion to dismiss plaintiff's complaint. This motion to dismiss was withdrawn after plaintiff filed an amended complaint on January 28, 2014, and on March 4, 2014 the Company and NMI filed a motion to dismiss the amended complaint. By a Decision/Order dated November 30, 2017, the court granted in part and denied in part the motion to dismiss the amended complaint. The court dismissed all claims except for plaintiff's claim for damages for breach of contract, to the extent that claim is based on the Company's and NMI's alleged failure to notify plaintiff of allegedly defective loans, and plaintiff's claim for indemnification. The court denied the motion to dismiss these claims without prejudice to the Company's and NMI's right to file a new motion to dismiss in conformity with procedures to be established in coordinated proceedings before the court addressing similar claims against numerous defendants. Briefing of the indemnification issue is now underway. Given the stage of the litigation, the Company cannot provide an estimate of the range of any loss. The Company has meritorious defenses to the case and expects to defend the case vigorously.

See "Reorganization" in Part I, Item 1. Business of the Form 10-K and Note 2 to the consolidated financial statements for a description of the Chapter 11 cases of Novation and the other Debtors.

Item 4. Mine Safety Disclosures

None.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's common stock currently trades on the OTC Pink marketplace of the OTC Markets Group, Inc. under the symbol "NOVC". Prior to the commencement of the Company's Chapter 11 case, the Company's common stock traded on the OTCQB market of the OTC Markets Group, Inc. under the symbol "NOVC." The following table sets forth the high and low bid prices as reported by these quotation services, for the periods indicated.

	<u>High</u>	<u>Low</u>
2017		
First Quarter	\$ 0.18	\$ 0.03
Second Quarter	0.23	0.12
Third Quarter	0.14	0.09
Fourth Quarter	0.12	0.06
2016		
First Quarter	\$ 0.14	\$ 0.05
Second Quarter	0.10	0.06
Third Quarter	0.08	0.03
Fourth Quarter	0.06	0.03

As of April 9, 2018, we had approximately 705 shareholders of record of the Company's common stock. This figure does not represent the actual number of beneficial owners of our common stock because such stock is frequently held in "street name" by securities dealers and others for the benefit of individual owners who may vote the shares.

No dividends were declared during 2017 or 2016 nor do we expect to declare any stock dividend distributions in the near future. The Note Purchase Agreement governing the Company's senior notes contains restrictive covenants which prohibit the Company and its subsidiaries, from among other things, making any cash dividend or distribution to Novation shareholders. Should the restrictions be relieved, any future determination to pay dividends will be made at the discretion of our Board and will depend on earnings, financial condition, cost of equity, investment opportunities and other factors as our Board may deem relevant.

Item 6. Selected Financial Data

Not applicable.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is a discussion and analysis of our financial condition and results of operations for the years ended December 31, 2017 and 2016. This discussion and analysis should be read in conjunction with our audited consolidated financial statements and Notes to the Consolidated Financial Statements set forth in Part II, Item 8, "Financial Statements and Supplementary Data" of this Form 10-K.

Corporate Overview

Through our wholly-owned subsidiary HCS, acquired on July 27, 2017, we provide outsourced health care staffing and related services in the State of Georgia. We also own a portfolio of mortgage securities which generate earnings to support on-going financial obligations. Our common stock, par value \$0.01 per share, is traded on the OTC Pink marketplace of the OTC Markets Group, Inc. under the symbol "NOVC".

See Part I, Item 1 of this Form 10-K for a discussion of recent events, including the completion of the HCS Acquisition and the Note Refinancing, and the effectiveness of the Plan on July 27, 2017.

Financial Highlights and Key Performance Metrics. The following key performance metrics (in thousands, except per share amounts) are derived from our consolidated financial statements for the periods presented and should be read in conjunction with the more detailed information therein and with the disclosure included in this report under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations."

	December 31,	
	2017	2016
Cash and cash equivalents	\$ 2,740	\$ 4,805
Marketable securities	\$ 11,795	\$ 36,488
Net income (loss) available to common shareholders, per basic and diluted share	\$ (0.12)	\$ 0.06

Consolidated Results of Operations

Year ended December 31, 2017 as Compared to the Year Ended December 31, 2016

Service Fee Income and Cost of Services

HCS delivers outsourced full-time and part-time employees primarily to Community Service Boards ("CSBs"), quasi state organizations that provide behavioral health services at facilities across Georgia including mental health services, developmental disabilities programs and substance abuse treatments. The State of Georgia has a total of 25 CSBs. Each CSB has a number of facilities, including crisis centers, outpatient centers and 24-hour group homes that require a broad range of employees, such as registered nurses, social workers, house parents and supervisors. The CSB market in Georgia is large and growing steadily, as the demand for the services provided by the CSBs continues to grow. In addition to providing outsourced employees to CSBs, HCS also provides healthcare outsourcing and staffing services to hospitals, schools and a variety of privately owned businesses. The services and positions provided to non CSB clients are similar to the ones provided to CSB clients. The service fee income and costs of services in the consolidated statement of operations and comprehensive income (loss) during 2017 are from the operations of HCS.

Future service fee income will be driven by the number customers and the volume of associates employed by the CSB and outsourced to HCS. Customer contracts typically establish a fixed markup on the pay rate for the associates; therefore the cost of services will generally fluctuate consistently with fee income. HCS offers a health and welfare benefit plan to its associates. The cost of this benefit is passed through to customers plus a small markup to cover cost of administration.

During the fourth quarter of 2017, HCS was notified that a customer would be significantly reducing the level of staff outsourced to HCS. The last pay period in 2017 was the final service period for these employees. This customer represented more than 20% of the Company's service fee income during 2017. While HCS has increased revenue from other sources and expects to continue adding new customers and adding revenue from existing customers, the Company does not expect to fully replace the lost revenue in the near term.

General and Administrative Expenses

General and administrative expenses consist of salaries, office costs, legal and professional expenses and other customary costs of corporate administration. The large increase in these expenses during 2017 results from the HCS Acquisition and the combination of HCS's expenses with those of Novation. During 2017, \$2.8 million of the total general and administrative expenses were incurred by HCS. Corporate-level general and administrative expenses during 2017 and 2016 were \$3.9 million and \$4.4 million, respectively. The costs associated with the HCS Acquisition was the primary reason for the increase in corporate-level general and administrative expenses.

The future amount of corporate-level general and administrative expenses will depend largely on corporate activities, professional fees associated with those activities and staffing needs based on the evolving business strategy. For HCS, the amount of these expenses will depend on business growth.

Goodwill Impairment Charge

As discussed above, during the fourth quarter of 2017, HCS was notified that a customer would be significantly reducing the level of staff outsourced to HCS. The last pay period in 2017 was the final service period for these employees. Accordingly, management completed a goodwill impairment assessment as of December 31, 2017, which determined that the carrying value of the HCS goodwill exceeded the fair value by \$4.5 million.

Interest Income – Mortgage Securities

Interest income on our mortgage securities decreased to approximately \$3.1 million in 2017 from \$5.1 million in 2016. Fluctuations in the interest income received from our mortgage portfolio are typically due to factors beyond the Company's control, such as the performance of the underlying loan collateral, prepayment speeds, interest rates, etc. The Company expects interest income and cash flow from these securities to decline as the principal on the underlying loan collateral is paid, written down, or written off. However, the Company owns overcollateralization ("OC") mortgage securities that are expected to generate cash flow. These securities represent the excess of securitized mortgage loan collateral over mortgage bonds sold to third parties. When the third party bonds are fully repaid, the mortgage loan principal and interest payments will be paid to the Company as the owner of the OC bonds. The timing of receipt of these payments is unknown and depends on the timing of the mortgage loan principal and interest payments.

Other Income

The Company uses available cash to acquire various equity and fixed income securities as part of its strategy to generate taxable earnings. Other income consists primarily of the interest, dividend, and other income received from these securities. Fluctuations in the income received from these securities results from the timing of purchases/sales and amounts of dividends and interest paid. Subsequent to the HCS Acquisition, the Company has significantly less available funds to invest. Therefore, for the foreseeable future, income related to investments is expected to be significantly lower than has been demonstrated through December 31, 2017.

	For the Year Ended December 31,	
	2017	2016
Dividends and interest income	\$ 230	\$ 1,741
Gains on sales of investments	137	3,672
Other	(19)	59
Total	\$ 348	\$ 5,472

Reorganization items, net

The Company has incurred significant costs associated with our reorganization and the Chapter 11 proceedings, which are being expensed as incurred. In addition, during 2016, a non-cash charge to write-off the unamortized debt issuance costs related to our 2011 Notes is included in "Reorganization items, net" as these debt instruments are expected to be impacted by the bankruptcy reorganization process. Reorganization items include (in thousands):

	For the Year Ended December 31,	
	2017	2016
Adjustments to deferred debt issuance costs and senior debt premium	\$ —	\$ 2,399
Professional fees	(3,460)	(1,252)
Adjustments to other liabilities for claims made or rejected contracts	(87)	(449)
Other	(34)	(31)
Reorganization items, net	\$ (3,581)	\$ 667

We expect these costs to decline significantly in 2018.

Interest Expense

Interest expense is comprised primarily of interest on our senior notes, which is variable based on 3-month LIBOR. Interest expense increased to \$3.9 million in 2017 from \$3.6 million in 2016. The increase in interest expense is a result of an increase in LIBOR.

Liquidity and Capital Resources

During 2017, the Company incurred a net loss of \$10.9 million and generated negative operating cash flow of \$8.7 million. As of December 31, 2017 the Company has an overall shareholders deficit of \$57.9 million. As of December 31, 2017, the Company had an aggregate of \$2.7 million in cash and cash equivalents and total liabilities of \$97.7 million. Of the \$2.7 million in cash, \$1.1 million is held by the Company's subsidiary NMLLC, which has filed a Chapter 11 plan of reorganization that remains subject to court approval. This cash is available to pay general creditors and expenses of NMLLC. The Company also has a significant on-going obligation to pay interest under its senior note agreement. In addition, beginning in 2018 a significant customer significantly reduced the level of staff outsourced to HCS.

On November 17, 2017, HCS entered into a Revolving Credit and Security Agreement, dated as of the same date (the "FNCC Credit Agreement"), with Federal National Payables, Inc. (d/b/a Federal National Commercial Credit) ("FNCC") providing HCS with a line of credit of up to \$5,000,000. Availability under the FNCC Credit Agreement is based on a formula tied to HCS's eligible accounts receivable, and borrowings under the FNCC Credit Agreement bear interest at the prime rate plus 1.25%. The FNCC Credit Agreement also provides for customary origination and collateral monitoring fees payable to FNCC during its term. The initial term of the FNCC Credit Agreement expires on November 17, 2018, but it will be renewed automatically for consecutive one-year terms thereafter unless the FNCC Credit Agreement is terminated pursuant to its terms. The obligations of HCS under the FNCC Credit Agreement are secured by HCS's inventory and accounts receivable.

The FNCC Credit Agreement contains customary representations, warranties and affirmative and negative covenants, including but not limited to financial covenants. The FNCC Credit Agreement also contains customary events of default, including but not limited to payment defaults, cross defaults with certain other indebtedness, breaches of covenants and bankruptcy events. In the case of an event of default, FNCC may, among other remedies, accelerate payment of all obligations under the FNCC Credit Agreement. In connection with the FNCC Credit Agreement, the Company executed a guaranty in favor of FNCC guaranteeing all of HCS's obligations under the FNCC Credit Agreement.

At the time of the Company's filing of its Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, management concluded that substantial doubt existed about the Company's ability to continue as a going concern within one year after the date that the consolidated financial statements were issued. Management's assessment was based on the expected negative impact on cash flow related to the loss of a significant customer of HCS. In addition, management was unsure of its ability to generate cash flow through other means, such as selling the Company's marketable securities at acceptable prices and uncertainty as to whether the Company could efficiently transfer the securities and receive cash proceeds in order to meet obligations as they come due.

Subsequent to that filing and subsequent to year end, the Company engaged a major investment firm to evaluate the marketplace for its mortgage securities. Management learned during that process that a market exists for the Company's mortgage securities and that those securities may be sold at prices acceptable to the Company. The Company executed trades to sell a portion of its overcollateralization mortgage securities. These sales are expected to generate \$2.9 million in cash proceeds for the Company. Management believes that other mortgage securities may be sold on similar terms in the event additional cash proceeds are needed. In addition, through the date of this filing, HCS has demonstrated that it can provide positive cash flow sufficient to support HCS operations. Management continues to work toward expanding HCS's customer base by increasing revenue from existing customers and targeting new customers that have not previously been served by HCS. In addition, management is exploring cost cutting initiatives that will reduce overall corporate overhead and operating costs.

While our historical operating results and poor cashflow suggest substantial doubt exists related to the Company's ability to continue as a going concern, management has concluded that the factors discussed above have alleviated the substantial doubt about the Company's ability to continue as a going concern within one year after the date that these consolidated financial statements are issued. The accompanying consolidated financial statements have been prepared on a basis that assumes the Company will continue as a going concern and contemplates the continuity of operations, realization of assets and the satisfaction of liabilities and commitments in the normal course of business.

Overview of Cash Flow for the Year Ended December 31, 2017

The following table provides a summary of our operating, investing and financing cash flows as taken from our consolidated statements of cash flows for 2017 and 2016 (in thousands).

	For the Year Ended December 31,	
	2017	2016
Consolidated Statements of Cash Flows:		
Cash flows (used in) provided by operating activities of continuing operations	\$ (9,621)	\$ 2,116
Cash flows provided by investing activities of continuing operations	3,510	1,591
Cash flows used in financing activities of continuing operations	3,151	(205)

Operating Activities

The decrease in net cash flows from operating activities to approximately \$9.6 million used in operating activities during 2017 from approximately \$2.1 million provided by operating activities during 2016 was driven primarily by the net loss and the payment of interest on the 2017 Notes and the Company's unpaid accounts payable and accrued expenses, primarily accrued professional fees.

Investing Activities

The increase in the net cash flows provided by investing activities is due primarily to proceeds from the sale of marketable securities, less the investment by the Company in HCS.

Financing Activities

During 2017, HCS entered into the FNCC Credit Agreement with FNCC providing HCS with a line of credit of up to \$5,000,000. Availability under the FNCC Credit Agreement is based on a formula tied to HCS's eligible accounts receivable. The Company's financing activities include the borrowings and payments under that credit facility during 2017.

Critical Accounting Estimates

We prepare our consolidated financial statements in conformity with GAAP and, therefore, are required to make estimates regarding the values of our assets and liabilities and in recording income and expenses. These estimates are based, in part, on our judgment and assumptions regarding various economic conditions that we believe are reasonable based on facts and circumstances existing at the time of reporting. These estimates affect reported amounts of assets, liabilities and accumulated other comprehensive income at the date of the consolidated financial statements and the reported amounts of income, expenses and other comprehensive income during the periods presented. The following summarizes the components of our consolidated financial statements where understanding accounting policies is critical to understanding and evaluating our reported financial results, especially given the significant estimates used in applying the policies. The discussion is intended to demonstrate the significance of estimates to our consolidated financial statements and the related accounting policies. Management has discussed the development and selection of these critical accounting estimates with the Audit Committee of our Board and the Audit Committee has reviewed our disclosure.

Marketable Securities

Our marketable securities include corporate equity and debt instruments and other traditional liquid investments, such as agency mortgage-backed securities. In addition, they include beneficial interests in the mortgage securitizations we executed prior to 2008. These beneficial interests include interest-only mortgage securities, residual interests and over-collateralization bonds, collectively "retained mortgage securities."

The accounting estimates used in valuing the retained mortgage securities and determining their income recognition rate are "critical accounting estimates" because they can materially affect net income (loss) and shareholders' equity. In order to determine value, we must forecast interest rates, mortgage principal payments, prepayments and loan default assumptions and when, or if, the servicer for the underlying mortgage loans will exercise optional redemption rights (the "call date"). Making these assumptions requires a large degree of judgment. The rate used to discount the projected cash flows is also critical in the valuation of our residual securities. Management's best estimate of key assumptions, including credit losses, prepayment speeds, expected call dates, market discount rates and forward yield curves commensurate with the risks involved, are used in estimating future cash flows.

We use historical collateral performance data, market economic data and published forward yield curves when modeling future expected cash flows and establishing the rate of income recognized on our retained mortgage securities. At each reporting date, future expected cash flows to be received is forecasted based on the assumptions made. The fair value of the retained mortgage securities is estimated by discounting these cash flows. We have relied heavily on historical performance of non-prime mortgage loans, in general, to determine assumptions. However, market trends for housing prices, labor statistics and other economic

factors have consistently improved for several years. Sufficient time has passed to suggest that these trends are sustainable. Therefore, we are now relying more heavily on the specific performance of these loans in forecasting cash flow from our retained mortgage securities. To date, these specific loans have performed significantly better than non-prime loans in general. Better performance by the underlying mortgage securities generally results in more cash flow and higher values for our retained mortgage securities.

We believe the value of our residual securities is appropriate, but can provide no assurance that future changes in interest rates, prepayment and loss experience or changes in the market discount rate will not require material adjustments to the retained mortgage securities. See Note 10 to the consolidated financial statements for additional information on the estimates used in the valuation of our retained mortgage securities.

Impairment of Goodwill and Indefinite-Lived Intangible Assets

The values of goodwill and trademarks are assessed annually to determine whether their carrying value exceeds their fair value. In addition, they are tested on an interim basis if an event occurs or circumstances change between annual tests that would more likely than not reduce their fair value below carrying value. If we determine the fair value of goodwill or trademarks is less than their carrying value, an impairment loss is recognized. Impairment losses, if any, are reflected in operating income or loss in the period incurred. The Company performs its annual tests of goodwill and trademarks during the second quarter of each fiscal year.

Impairment of Long-Lived Assets with Finite Lives

The value of purchased intangible assets is assessed for impairment whenever an event or change in circumstances indicates that the carrying value of the asset may not be fully recoverable. Recoverability is determined based on an estimate of undiscounted future cash flows resulting from the use of an asset and its eventual disposition. An impairment loss is measured by comparing the fair value of the asset to its carrying value. If we determine the fair value of an asset is less than the carrying value, an impairment loss is incurred. Impairment losses, if any, are reflected in operating income or loss in our consolidated statements of operations during the period incurred.

Income Taxes

In determining the amount of deferred tax assets to recognize in the consolidated financial statements, the Company evaluates the likelihood of realizing such benefits in future periods. The income taxes guidance requires the recognition of a valuation allowance if it is more likely than not that all or some portion of the deferred tax asset will not be realized. Income tax guidance indicates the more likely than not threshold is a level of likelihood that is more than 50%.

Under the income tax guidance, companies are required to identify and consider all available evidence, both positive and negative, in determining whether it is more likely than not that all or some portion of its deferred tax assets will not be realized. Positive evidence includes, but is not limited to the following: cumulative earnings in recent years, earnings expected in future years, excess appreciated asset value over the tax basis and positive industry trends. Negative evidence includes, but is not limited to the following: cumulative losses in recent years, losses expected in future years, a history of operating losses or tax credit carryforwards expiring, and adverse industry trends.

The weight given to the potential effect of negative and positive evidence should be commensurate with the extent to which it can be objectively verified. The more negative evidence that exists, the more positive evidence is required to counter to support a conclusion that a valuation allowance is not needed for all or some of the deferred tax assets. Cumulative losses in recent years are significant negative evidence that is difficult to overcome when determining the need for a valuation allowance. Similarly, cumulative earnings in recent years represent significant positive objective evidence. If the weight of the positive evidence is sufficient to support a conclusion that it is more likely than not that a deferred tax asset will be realized, a valuation allowance should not be recorded.

The Company examines and weighs all available evidence (both positive and negative and both historical and forecasted) in the process of determining whether it is more likely than not that a deferred tax asset will be realized. The Company considers the relevance of historical and forecasted evidence when there has been a significant change in circumstances. Additionally, the Company evaluates the realization of its recorded deferred tax assets on an interim and annual basis. The Company does not record a full valuation allowance if the weight of the positive evidence exceeds the negative evidence and is sufficient to support a conclusion that it is more likely than not that its deferred tax asset will be realized.

If a valuation allowance is necessary, the Company considers all sources of taxable income in determining the amount of valuation allowance to be recorded. Sources of taxable income identified in the income tax guidance include the following: 1) taxable income in prior carryback year, 2) future reversals of existing taxable temporary differences, 3) future taxable income exclusive of reversing temporary differences and carryforwards, and 4) tax planning strategies.

The Company currently evaluates estimates of uncertainty in income taxes based upon a framework established in the income tax accounting guidance. The guidance prescribes a recognition threshold and measurement standard for the recognition and measurement of tax positions taken or expected to be taken in a tax return. In accordance with the guidance, the Company

evaluates whether a tax position will more likely than not be sustained upon examination by the appropriate taxing authority. The Company measures the amount to recognize in its consolidated financial statements as the largest amount that is greater than 50% likely of being realized upon ultimate settlement. The recognition and measurement of tax benefits is often judgmental, and determinations regarding the tax benefit can change as additional developments occur relative to the issue.

Impact of Recently Issued Accounting Pronouncements

Information regarding the impact of recently issued accounting pronouncements is included in Note 3 to the consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Not applicable.

Item 8. Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Stockholders of Novation Companies, Inc.

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Novation Companies, Inc. (the Company) as of December 31, 2017 and 2016, and the related statements of operations and comprehensive income (loss), shareholders deficit, and cash flows for each of the years in the two-year period ended December 31, 2017, and the related notes (collectively referred to as the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ BOULAY PLLP

We have served as the Company's auditor since 2016.

Minneapolis, Minnesota

April 10, 2018

NOVATION COMPANIES, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)

	December 31,	
	2017	2016
Assets		
Current Assets		
Cash and cash equivalents	\$ 2,740	\$ 4,805
Accounts and unbilled receivables	7,922	—
Marketable securities	11,795	9,943
Other current assets	578	1,091
Total current assets	<u>23,035</u>	<u>15,839</u>
Non-Current Assets		
Goodwill	8,205	—
Intangible assets, net	8,172	—
Marketable securities	—	26,545
Other	425	246
Total non-current assets	<u>16,802</u>	<u>26,791</u>
Total assets	<u>\$ 39,837</u>	<u>\$ 42,630</u>
Liabilities and Shareholders' Deficit		
Liabilities:		
Current Liabilities		
Borrowings under revolving line of credit	\$ 3,333	\$ —
Accrued compensation and benefits payable	4,213	75
Accrued professional fees payable	1,037	691
Accrued interest payable	1,050	3,689
Other	1,650	1,063
Total current liabilities	<u>11,283</u>	<u>5,518</u>
Non-Current Liabilities		
Long-term debt	86,050	85,938
Other	386	373
Total non-current liabilities	<u>86,436</u>	<u>86,311</u>
Total liabilities	<u>97,719</u>	<u>91,829</u>
Commitments and contingencies		
Shareholders' Deficit:		
Capital stock, \$0.01 par value per share, 120,000,000 shares authorized:		
Common stock, 97,138,750 and 92,844,907 shares issued and outstanding as of December 31, 2017 and 2016, respectively	971	928
Additional paid-in capital	744,937	744,873
Accumulated deficit	(815,184)	(804,319)
Accumulated other comprehensive income	11,394	9,319
Total shareholders' deficit	<u>(57,882)</u>	<u>(49,199)</u>
Total liabilities and shareholders' deficit	<u>\$ 39,837</u>	<u>\$ 42,630</u>

See notes to consolidated financial statements.

NOVATION COMPANIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(in thousands, except share and per share amounts)

	For the Year Ended December 31,	
	2017	2016
Service fee income	\$ 27,965	\$ —
Cost and expenses:		
Cost of services	24,473	—
General and administrative	6,713	4,367
Goodwill impairment charge	4,500	—
Operating loss	(7,721)	(4,367)
Interest income – mortgage securities	3,143	5,060
Other income (expense)	348	5,472
Reorganization items, net	(3,581)	667
Interest expense	(3,935)	(3,606)
Income (loss) from continuing operations before income taxes	(11,746)	3,226
Income tax expense (benefit)	14	(21)
Net income (loss) from continuing operations	(11,760)	3,247
Income from discontinued operations, net of income taxes	895	1,966
Net income (loss)	(10,865)	5,213
Other comprehensive income:		
Less reclassification gain included in net income	(137)	(3,672)
Change in unrealized gain (loss) on marketable securities	2,212	11,555
Other comprehensive income (loss)	2,075	7,883
Net comprehensive income (loss)	\$ (8,790)	\$ 13,096
Earnings (loss) per common share:		
Basic	\$ (0.12)	\$ 0.06
Diluted	\$ (0.12)	\$ 0.06
Weighted average basic common shares outstanding	92,800,392	91,905,941
Weighted average diluted common shares outstanding	92,800,392	91,905,941

NOVATION COMPANIES, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' DEFICIT
(in thousands)

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Shareholders' Deficit
Balance, December 31, 2016	\$ 928	\$ 744,873	\$ (804,319)	\$ 9,319	\$ (49,199)
Issuance of nonvested shares	43	(43)	—	—	—
Compensation recognized under stock compensation plans	—	107	—	—	107
Net loss	—	—	(10,865)	—	(10,865)
Other comprehensive income	—	—	—	2,075	2,075
Balance, December 31, 2017	<u>\$ 971</u>	<u>\$ 744,937</u>	<u>\$ (815,184)</u>	<u>\$ 11,394</u>	<u>\$ (57,882)</u>
Balance, December 31, 2015	\$ 928	\$ 744,575	\$ (809,532)	\$ 1,436	\$ (62,593)
Compensation recognized under stock compensation plans	—	298	—	—	298
Net income	—	—	5,213	—	5,213
Other comprehensive income	—	—	—	7,883	7,883
Balance, December 31, 2016	<u>\$ 928</u>	<u>\$ 744,873</u>	<u>\$ (804,319)</u>	<u>\$ 9,319</u>	<u>\$ (49,199)</u>

See notes to consolidated financial statements.

NOVATION COMPANIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Year Ended December 31,	
	2017	2016
Cash flows from operating activities:		
Net income (loss)	\$ (10,865)	\$ 5,213
Income from discontinued operations, net of income taxes	895	1,966
Net income (loss) from continuing operations	(11,760)	3,247
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Goodwill impairment charge	4,500	—
Gains on sales of marketable securities, net	(137)	(3,672)
Accretion of marketable securities, net	58	16
Adjustments to and amortization of deferred debt issuance costs and senior debt discount	—	(2,447)
Compensation recognized under stock compensation plans	107	274
Amortization of intangible assets	496	—
Changes in operating assets and liabilities, net of acquisition:		
Accounts receivable	(457)	—
Accrued professional fees payable	346	315
Accrued compensation and benefits payable	(613)	(200)
Accrued interest payable	(2,639)	3,687
Due from discontinued operations	—	(26)
Other current assets and liabilities, net	63	329
Other noncurrent assets and liabilities, net	415	593
Net cash provided by (used in) operating activities of continuing operations	(9,621)	2,116
Net cash provided by (used in) operating activities of discontinued operations	895	(1,921)
Net cash provided by (used in) operating activities	(8,726)	195
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	26,847	33,468
Purchase of business, net of cash received	(23,337)	—
Proceeds from sale of subsidiary	—	7,643
Purchases of available for sale securities	—	(39,520)
Net cash provided by investing activities of continuing operations	3,510	1,591
Net cash used in investing activities of discontinued operations	—	(159)
Net cash provided by investing activities	3,510	1,432
Cash flows from financing activities:		
Borrowings under revolving line of credit	10,043	—
Repayments of borrowings under revolving line of credit	(6,710)	—
Paydowns of long-term debt	(182)	—
Cash receipts from distributions of earnings from discontinued operations	—	(205)
Net cash used in financing activities of continuing operations	3,151	(205)
Net cash provided by financing activities of discontinued operations	—	205
Net cash provided by financing activities	3,151	—
Net increase (decrease) in cash and cash equivalents	(2,065)	1,627
Cash and cash equivalents, beginning of period	4,805	3,178
Cash and cash equivalents, end of period	<u>\$ 2,740</u>	<u>\$ 4,805</u>

**For the Year Ended
December 31,**

	2017	2016
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Supplemental disclosure of cash flow information:

Cash paid for reorganization items	\$ 4,501	\$ 902
Cash paid for interest	\$ 6,557	\$ —
Cash income taxes paid, net	\$ —	(17)

Supplemental disclosure of financing and investing activities:

Assets acquired and liabilities assumed in connection with purchase of business:

Cash and cash equivalents	\$ 246	\$ —
Accounts receivable	7,465	—
Other current assets	59	—
Other assets	581	—
Intangible assets	8,669	—
Goodwill	12,705	—
Accrued compensation and benefits	(4,751)	—
Long-term debt, including current portion of \$426	(683)	—
Other current liabilities	(708)	—
Purchase price	\$ 23,583	\$ —

See notes to consolidated financial statements.

NOVATION COMPANIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation, Business Plan and Liquidity

Description of Operations – Novation Companies, Inc. and its subsidiaries (the “Company,” “Novation,” “we,” or “us”), through Healthcare Staffing, Inc. (“HCS”), our wholly-owned subsidiary acquired on July 27, 2017, provides outsourced health care staffing and related services in the State of Georgia. We also own a portfolio of mortgage securities which generate earnings to support on-going financial obligations. Our common stock, par value \$0.01 per share, is traded on the OTC Pink marketplace of the OTC Markets Group, Inc. under the symbol “NOVC”.

Liquidity and Going Concern – During 2017, the Company incurred a net loss of \$10.9 million and generated negative operating cashflow of \$8.7 million. As of December 31, 2017 the Company has an overall shareholders deficit of \$57.9 million. As of December 31, 2017 the Company had an aggregate of \$2.7 million in cash and cash equivalents and total liabilities of \$97.7 million. Of the \$2.7 million in cash, \$1.1 million is held by the Company's subsidiary NovaStar Mortgage LLC (“NMLLC”), which has filed a Chapter 11 plan of reorganization that remains subject to court approval. This cash is available to pay general creditors and expenses of NMLLC. The Company also has a significant on-going obligation to pay interest under its senior note agreement. In addition, beginning in 2018 a significant customer significantly reduced the level of staff outsourced to HCS.

At the time of the Company's filing of its Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, management concluded that substantial doubt existed about the Company's ability to continue as a going concern within one year after the date that the consolidated financial statements were issued. Management's assessment was based on the expected negative impact on cash flow related to the loss of a significant customer of HCS. In addition, management was unsure of its ability to generate cash flow through other means, such as selling the Company's marketable securities at acceptable prices and uncertainty as to whether the Company could efficiently transfer the securities and receive cash proceeds in order to meet obligations as they come due.

Subsequent to that filing and subsequent to year end, the Company engaged a major investment firm to evaluate the marketplace for its mortgage securities. Management learned during that process that a market exists for the Company's mortgage securities and that those securities may be sold at prices acceptable to the Company. The Company executed trades to sell a portion of its overcollateralization mortgage securities. These sales are expected to generate \$2.9 million in cash proceeds for the Company. Management believes that other mortgage securities may be sold on similar terms in the event additional cash proceeds are needed. In addition, through the date of this filing, HCS has demonstrated that it can provide positive cash flow sufficient to support HCS operations. Management continues to work toward expanding HCS's customer base by increasing revenue from existing customers and targeting new customers that have not previously been served by HCS. In addition, management is exploring cost cutting initiatives that will reduce overall corporate overhead and operating costs.

While our historical operating results and poor cashflow suggest substantial doubt exists related to the Company's ability to continue as a going concern, management has concluded that the factors discussed above have alleviated the substantial doubt about the Company's ability to continue as a going concern within one year after the date that these consolidated financial statements are issued. The accompanying consolidated financial statements have been prepared on a basis that assumes the Company will continue as a going concern and contemplates the continuity of operations, realization of assets and the satisfaction of liabilities and commitments in the normal course of business.

We cannot provide assurance that revenue generated from our businesses will be sufficient to sustain our operations in the long term. Additionally, we cannot be certain that we will be successful at raising capital, whether from divesting of mortgage securities or other assets, or from equity or debt financing, on commercially reasonable terms, if at all. Such failures would have a material adverse effect on our business, including the possible cessation of operations.

Financial Statement Presentation. The Company's consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expense during the period. The Company uses estimates and judgments in establishing the fair value of its mortgage securities, assessing the recoverability of goodwill intangible assets and accounting for income taxes, including the determination of the timing of the establishment or release of the valuation allowance related to the deferred tax asset balances and reserves for uncertain tax positions. While the consolidated financial statements and footnotes reflect the best estimates and judgments of management at the time, actual results could differ significantly from those estimates.

Note 2. Reorganization

On July 20, 2016, (the “Bankruptcy Petition Date”), Novation and three of its subsidiaries, NMLLC, NovaStar Mortgage Funding Corporation and 2114 Central LLC (collectively, the “Debtors”), filed voluntary petitions (the “Bankruptcy Petitions”) for reorganization under Chapter 11 Title 11 of the United States Code (the “Bankruptcy Code”) in the United States Bankruptcy

Court for the District of Maryland (the "Bankruptcy Court"). The Company and one of its subsidiaries subsequently filed with the Bankruptcy Court, and amended, a plan of reorganization for the resolution of the outstanding claims against and interests pursuant to Section 1121(a) of the Bankruptcy Code (as amended and supplemented, the "Plan") and a related disclosure statement. The Bankruptcy Court entered an order on June 12, 2017 confirming the Plan (the "Confirmation Order") solely with respect to the Company, which provided that the effective date of the Plan would occur when all conditions precedent to effectiveness, as set forth in the Plan, had been satisfied or waived.

Two of the conditions to the effectiveness of the Plan were (i) the closing of the Company's acquisition (the "HCS Acquisition") of all of the capital stock of HCS as discussed in Note 4 and (ii) the restructuring (the "Note Refinancing") of the Company's outstanding Series 1 Notes, Series 2 Notes and Series 3 Notes (collectively, the "2011 Notes"), held by Taberna Preferred Funding I, Ltd. ("Taberna I"), Taberna Preferred Funding II, Ltd. ("Taberna II") and Kodiak CDO I, Ltd. ("Kodiak" and, together with Taberna I and Taberna II, the "Noteholders"), issued pursuant to three Indentures, each dated as of March 22, 2011 (the "Indentures"), between the Company and The Bank of New York Mellon Trust Company, National Association. The HCS Acquisition and the Note Refinancing were completed on July 27, 2017, and are discussed in Note 4 and Note 8, respectively.

On July 27, 2017, upon the completion of the HCS Acquisition and the Note Refinancing, and the satisfaction or waiver of all other conditions precedent to effectiveness, the effective date of the Plan occurred and the Company filed a Notice of Occurrence of Effective Date of the Plan with the Bankruptcy Court. Under the Plan, holders of existing equity interests in the Company (i.e., the common stock) retained their interests.

On September 25, 2017, the bankruptcy case of 2114 Central, LLC was dismissed by order of the Bankruptcy Court. Thereafter, on December 22, 2017, NMLLC filed with the Bankruptcy Court a Chapter 11 plan of reorganization, and on December 26, 2017 filed a related disclosure statement. The Bankruptcy Court entered an order on February 16, 2018 approving the disclosure statement, as revised. The Bankruptcy Court will conduct a hearing on April 11, 2018 to consider confirmation of NMLLC's plan of reorganization.

We incurred significant costs associated with our reorganization and the Chapter 11 proceedings. These costs, which are being expensed as incurred, include (in thousands):

	<u>Year Ended December 31,</u>	
	<u>2017</u>	<u>2016</u>
Adjustments to deferred debt issuance costs and senior debt premium	\$ —	\$ 2,399
Professional fees	(3,460)	(1,252)
Adjustments to other liabilities for claims made or rejected contracts	(87)	(449)
Other	(34)	(31)
Reorganization items, net	<u><u>\$(3,581)</u></u>	<u><u>\$ 667</u></u>

Note 3. Summary of Significant Accounting and Reporting Policies

Recently Adopted Accounting Principles. In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment* to eliminate a step in the quantitative goodwill impairment test. The new single quantitative step test requires companies to compare the fair value of a reporting unit with its carrying amount and record an impairment charge for the amount that the carrying amount exceeds the fair value, up to the total amount of goodwill allocated to that reporting unit. The Company will continue to have the option of first performing a qualitative assessment to determine whether it is necessary to complete the quantitative goodwill impairment test. The Company early adopted this guidance in the fourth quarter of 2017 by applying the single quantitative step test to our interim goodwill impairment analysis. See Note 7.

Cash and Cash Equivalents. Cash equivalents consist of liquid investments with an original maturity of three months or less. Cash equivalents are stated at cost, which approximates fair value. The Company maintains cash balances at four major financial institutions in the United States. Accounts are secured by the Federal Deposit Insurance Corporation up to \$250,000. The uninsured balances of the Company's unrestricted cash and cash equivalents accounts aggregated \$2.0 million as of December 31, 2017.

Accounts and Unbilled Receivables. Accounts receivable are uncollateralized customer obligations due under normal trade terms. Customer account balances that are not paid within contract terms are considered delinquent. Accounts receivable are stated at the amount management expects to collect from outstanding balances. The Company maintains an allowance for potential losses primarily based upon management's analysis of delinquent accounts, routine assessment of its customers' financial condition, and any other known factors impacting collectability, including disputed amounts. When management has exhausted all collection efforts, amounts deemed uncollectible are written off. Recoveries of previously written off accounts receivable are recognized in the period in which they are received. The ultimate amount of accounts receivable that becomes uncollectible could differ from management's estimate.

Marketable Securities – Available-for-Sale. Marketable securities are stated at fair value in accordance with the relevant accounting guidance. The Company determines the fair value of its marketable securities based on pricing from our third party service provider and market prices from industry-standard independent data providers. Such market prices may be quoted prices in active markets for identical assets (Level 1 inputs) or pricing determined using inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs), such as yield curve, volatility factors, credit spreads, default rates, loss severity, current market and contractual prices for the underlying instruments or debt, broker and dealer quotes, as well as other relevant economic measures. To the extent observable inputs are not available, as is the case with the Company's mortgage securities – available-for-sale, the Company estimates fair value using significant unobservable inputs (Level 3 inputs). The methods and processes used to estimate the fair value of the Company's mortgage securities are discussed further below.

Mortgage securities – available-for-sale represent beneficial interests the Company retains in securitization transactions which consist of residual interests (the "residual securities") in certain components of the cash flows of the underlying mortgage loans to the securitization trusts. As payments are received on the residual securities, the payments are applied to the cost basis of the related mortgage securities. Each period, the accretible yield for each mortgage security is evaluated and, to the extent there has been a change in the estimated cash flows, it is adjusted and applied prospectively. The accretible yield is recorded as interest income with a corresponding increase to the carrying basis of the mortgage security. The Company estimates the fair value of its residual securities retained based on the present value of future expected cash flows to be received, except for those securities for which a portion was sold subsequent to year end as discussed in Note 10. Management's best estimate of key assumptions, including credit losses, prepayment speeds, market discount rates and forward yield curves commensurate with the risks involved, are used in estimating future cash flows.

All of the Company's available-for-sale securities are reported at their estimated fair value with unrealized gains and losses reported in accumulated other comprehensive income. To the extent the cost basis of these securities exceeds the estimated fair value and the unrealized loss is considered to be other than temporary, an impairment charge is recognized and the amount recorded in accumulated other comprehensive income or loss is reclassified to earnings as a realized loss. The Company uses the specific identification method in computing realized gains or losses.

Goodwill and Indefinite-Lived Intangible Assets. Goodwill and trademarks are assessed annually to determine whether their carrying value exceeds their fair value. In addition, they are tested on an interim basis if an event occurs or circumstances change between annual tests that would more likely than not reduce their fair value below carrying value. If we determine the fair value of goodwill or trademarks is less than their carrying value, an impairment loss is recognized. Impairment losses, if any, are reflected in operating income or loss in the period incurred. The Company performs its annual tests of goodwill and trademarks during the second quarter of each fiscal year.

Impairment of Long-Lived Intangible Assets with Finite Lives. Long-lived intangible assets held and used by us which have finite lives are assessed for impairment whenever an event or change in circumstances indicates that the carrying value of the asset may not be fully recoverable. Recoverability is determined based on an estimate of undiscounted future cash flows resulting from the use of an asset and its eventual disposition. An impairment loss is measured by comparing the fair value of the asset to its carrying value. If we determine the fair value of an asset is less than the carrying value, an impairment loss is incurred. Impairment losses, if any, are reflected in operating income or loss in the period incurred.

Revenue and Cost Recognition - The Company recognizes revenue when there is persuasive evidence of an arrangement, the service has been provided to the customer, fees for services are fixed or determinable and collectability is reasonably assured. HCS's revenue is generated from time and material contracts where there is a signed agreement in place that specifies the fixed hourly rate and other reimbursable costs to be billed based on direct labor hours incurred. Revenue is recognized on these contracts based on direct labor hours and reimbursable costs incurred.

During 2017, 43% of Service Fee Income was generated from two customers and 98% was generated from 16 Community Service Board ("CSB") customers. As of December 31, 2017, 48% of accounts and unbilled receivables were due from three customers and 97% was due from the 16 CSB customers.

Income Taxes. The Company had a gross deferred tax asset of \$164.7 million and \$295.9 million as of December 31, 2017 and 2016, respectively. In determining the amount of deferred tax assets to recognize in the consolidated financial statements, the Company evaluates the likelihood of realizing such benefits in future periods. The income tax guidance requires the recognition of a valuation allowance if it is more likely than not that all or some portion of the deferred tax asset will not be realized. Income tax guidance indicates the more likely than not threshold is a level of likelihood that is more than 50%.

Under the income tax guidance, companies are required to identify and consider all available evidence, both positive and negative, in determining whether it is more likely than not that all or some portion of its deferred tax assets will not be realized. Positive evidence includes, but is not limited to the following: cumulative earnings in recent years, earnings expected in future years, excess appreciated asset value over the tax basis and positive industry trends. Negative evidence includes, but is not limited to the following: cumulative losses in recent years, losses expected in future years, a history of operating losses or tax credit carryforwards expiring, and adverse industry trends.

The weight given to the potential effect of negative and positive evidence should be commensurate with the extent to which it can be objectively verified. The more negative evidence that exists, the more positive evidence is required to counter to support a conclusion that a valuation allowance is not needed for all or some of the deferred tax assets. Cumulative losses in recent years are significant negative evidence that is difficult to overcome when determining the need for a valuation allowance. Similarly, cumulative earnings in recent years represent significant positive objective evidence. If the weight of the positive evidence is sufficient to support a conclusion that it is more likely than not that a deferred tax asset will be realized, a valuation allowance should not be recorded.

The Company examines and weighs all available evidence (both positive and negative and both historical and forecasted) in the process of determining whether it is more likely than not that a deferred tax asset will be realized. The Company considers the relevance of historical and forecasted evidence when there has been a significant change in circumstances. Additionally, the Company evaluates the realization of its recorded deferred tax assets on an interim and annual basis. The Company does not record a full valuation allowance if the weight of the positive evidence exceeds the negative evidence and is sufficient to support a conclusion that it is more likely than not that its deferred tax asset will be realized.

If a valuation allowance is necessary, the Company considers all sources of taxable income in determining the amount of valuation allowance to be recorded. Sources of taxable income identified in the income tax guidance include the following: 1) taxable income in prior carryback year, 2) future reversals of existing taxable temporary differences, 3) future taxable income exclusive of reversing temporary differences and carryforwards, and 4) tax planning strategies.

The Company currently evaluates estimates of uncertainty in income taxes based upon a framework established in the income tax accounting guidance. The guidance prescribes a recognition threshold and measurement standard for the recognition and measurement of tax positions taken or expected to be taken in a tax return. In accordance with the guidance, the Company evaluates whether a tax position will more likely than not be sustained upon examination by the appropriate taxing authority. The Company measures the amount to recognize in its consolidated financial statements as the largest amount that is greater than 50% likely of being realized upon ultimate settlement. The recognition and measurement of tax benefits is often judgmental, and determinations regarding the tax benefit can change as additional developments occur relative to the issue.

Earnings (Loss) Per Share (“EPS”). Basic EPS excludes dilution and is computed by dividing net income (loss) available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. Diluted EPS is calculated assuming all options, nonvested shares and performance-based awards of the Company's common stock have been exercised, unless the exercise would be antidilutive. See Note 11 to the consolidated financial statements for additional details on earnings per share calculation.

New Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, which amended Revenue from Contracts with Customers (Topic 606). The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. With respect to public entities, this guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. Early application is not permitted. The Company has determined the adoption of this guidance will have no material impact on the way revenue is recognized. Additional disclosure will be required in the footnotes to the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This ASU requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize in its balance sheet a liability to make lease payments and an asset representing its right to use the underlying asset for the lease term. This guidance is effective for annual and interim reporting periods beginning after December 15, 2018. The amendments should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is evaluating the impact this guidance will have on its consolidated financial statements.

Note 4. Acquisition and Divestiture

Acquisition of Healthcare Staffing, Inc. On February 1, 2017, the Company entered into a Stock Purchase Agreement (the “HCS Purchase Agreement”) with Novation Holding, Inc., a wholly-owned subsidiary of the Company (“NHI”), HCS and Butler America, LLC, the owner of HCS (“Butler” and, together with HCS, the “Seller Parties”). Pursuant to the HCS Purchase Agreement, NHI agreed to purchase from Butler all of the outstanding capital stock of HCS for \$24.0 million in cash, subject to terms and conditions as provided therein, including but not limited to the Company's receipt of bankruptcy court approval for the HCS Acquisition in its Chapter 11 case. The purchase price was subject to a potential working capital adjustment, based on HCS having \$5.0 million of working capital at closing.

On July 27, 2017, in connection with the anticipated closing of the HCS Acquisition, the Company, NHI, HCS and Butler entered into a Closing Agreement, dated as of the same date (the “Closing Agreement”), relating to certain closing matters and the terms

of the HCS Purchase Agreement. The Closing Agreement provided for the following: (i) eliminate the \$240,000 indemnification escrow under the HCS Purchase Agreement; (ii) provide for NHI's reimbursement to Butler of \$100,000 in costs and expenses incurred by Butler in consideration for the delay in closing the HCS Acquisition; (iii) clarify the treatment of certain of HCS's outstanding tax obligations; (iv) provide that an adjustment to the purchase price under the HCS Purchase Agreement will be made in connection with the calculation of final closing date net working capital of HCS only if there is a difference between such amount and the pre-closing estimate of greater than three percent; and (v) make certain other changes to the HCS Purchase Agreement. We have made claims against Butler for a working capital adjustment, indemnification and other reimbursements and payments under the terms of the HCS Purchase Agreement and are in discussions with Butler regarding these claims. As of the date of this filing, the claims are unresolved and the Company has not recorded any amounts for these claims in the consolidated financial statements.

On July 27, 2017, the Company and NHI completed the HCS Acquisition pursuant to the terms of the HCS Purchase Agreement and the Closing Agreement, as a result of which HCS became a wholly-owned subsidiary of NHI.

The net purchase price was allocated as follows (in thousands):

Cash	\$ 246
Accounts receivable	7,465
Other assets	59
Property and equipment	581
Intangible assets:	
Customer relationships	6,895
Trademark	1,147
Non-compete	627
Goodwill	12,705
Accrued compensation and benefits	(4,751)
Long-term debt, including current portion of \$426	(683)
Other current liabilities	(708)
Net assets acquired	<u>\$ 23,583</u>

The purchase price was allocated to the tangible and intangible assets acquired and the liabilities assumed at their estimated fair values as of the acquisition date. The fair value measurements of the assets acquired and liabilities assumed were based on valuations involving significant unobservable inputs, or Level 3 in the valuation hierarchy. The allocation of the purchase price above to the assets and liabilities are based on our preliminary assessment and is subject to further review pending the completion of an appraisal of certain assets and liabilities acquired.

The gross contractual amount of accounts receivable is \$7.5 million, which approximates fair value. Goodwill and trademarks are considered indefinite-lived assets and are not subject to future amortization, but will be tested for impairment at least annually. Goodwill is comprised primarily of processes for services and knowhow, assembled workforces and other intangible assets that do not qualify for separate recognition. The amortization period for the intangibles for customer relationships and the non-compete agreement are seven and three years, respectively. The goodwill will be deductible for tax purposes.

HCS's results are included in our consolidated statement of operations beginning July 27, 2017. The following unaudited pro forma financial information presents the combined results of HCS and Novation as if the HCS Acquisition had occurred on January 1, 2016 (in thousands). The unaudited pro forma financial information is not necessarily indicative of what our consolidated results of operations actually would have been or what results may be expected in the future.

	For the Year Ended December 31,	
	2017	2016
Service fee income	<u>\$ 63,246</u>	<u>\$ 55,161</u>
Income (loss) from continuing operations	<u>\$ (9,331)</u>	<u>\$ 3,903</u>
Net income (loss)	<u>\$ (8,450)</u>	<u>\$ 5,869</u>
Basic and diluted earnings per share:		
Net income (loss) from continuing operations	<u>\$ (0.10)</u>	<u>\$ 0.04</u>
Net income (loss)	<u>\$ (0.09)</u>	<u>\$ 0.06</u>

Included in general and administrative expenses, primarily during 2017, are approximately \$1.3 million in fees associated with the HCS Acquisition, including \$0.9 million in investment advisor fees.

Sale of Corvisa LLC. Subject to the terms and conditions of the Membership Interest Purchase Agreement, dated as of December 21, 2015, by and among the Company, Corvisa Services, LLC ("Corvisa") and ShoreTel, Inc. ("Shoretel"), ShoreTel agreed to purchase 100% of the membership interests of Corvisa, at the time a wholly-owned subsidiary of the Company. The sale closed on January 6, 2016. During the first quarter of 2017, the Company received \$1.0 million from the release of the indemnification escrow which was recorded as a gain and included in discontinued operations during 2017.

Results of Discontinued Operations - The results of the Company's discontinued operations are summarized below (in thousands):

	For the Year Ended December 31,	
	2017	2016
Recognition of gain upon release of indemnification escrow - Corvisa sale	\$1,020	\$ —
Gain on sale of Corvisa	—	1,966
Expenses related to discontinued operations	(125)	—
Income from discontinued operations, net of income taxes	<u>\$ 895</u>	<u>\$ 1,966</u>

The assets and liabilities of discontinued operations are not material.

Note 5. Accounts and Unbilled Receivables

	December 31, 2017 (in thousands)
Accounts receivable	\$ 5,418
Unbilled receivables	2,504
	<u>\$ 7,922</u>

As of December 31, 2017, management has determined no allowance for doubtful accounts is necessary.

Note 6. Marketable Securities

The Company's portfolio of available-for-sale securities includes (dollars in thousands):

	Amortized Cost	Gross Unrealized		Estimated Fair Value
		Gains	Losses	
As of December 31, 2017				
Marketable securities, current				
Mortgage securities	\$ 400	\$ 11,394	\$ —	\$ 11,794
Equity securities	1	—	—	1
Total	<u>\$ 401</u>	<u>\$ 11,394</u>	<u>\$ —</u>	<u>\$ 11,795</u>
As of December 31, 2016				
Marketable securities, current				
Mortgage securities	\$ 450	\$ 9,341	\$ —	\$ 9,791
Equity securities	112	47	(7)	152
Total	<u>\$ 562</u>	<u>\$ 9,388</u>	<u>\$ (7)</u>	<u>\$ 9,943</u>
Marketable securities, non-current				
Agency mortgage-backed securities	<u>\$ 26,607</u>	<u>\$ —</u>	<u>\$ (62)</u>	<u>\$ 26,545</u>

See Note 10 for a discussion of the Company's fair value methods and measurements.

During 2017, the Company's entire portfolio of agency mortgage-backed securities was sold. Proceeds from the sale were \$25.2 million and a gain of \$79 thousand recognized, included in other income in the Company's consolidated statements of operations and comprehensive income (loss).

Prior to 2016, the Company originated, purchased, securitized, sold, invested in and serviced residential nonconforming mortgage loans and mortgage securities. As a result of those activities, the Company holds mortgage securities that continue to be a source of its earnings and cash flow. As of December 31, 2017 and 2016, these mortgage securities consisted entirely of the Company's investment in the residual securities issued by securitization trusts sponsored by the Company. Residual securities consist of interest-only and overcollateralization bonds. There were no other-than-temporary impairments relating to available-for-sale securities for 2017 and 2016. Maturities of retained mortgage securities owned by the Company depend on repayment characteristics and experience of the underlying financial instruments. See Note 10 to the consolidated financial statements for details on the Company's fair value methodology.

The following table relates to the securitizations where the Company retained an interest in the assets issued by the securitization trust (in thousands):

	Principal Outstanding (A)	Assets on Balance Sheet (B)	Liabilities on Balance Sheet	Maximum Exposure to Loss(B)	Year to Date Loss on Sale	Year to Date Cash Flows
December 31, 2017	\$ 2,714,823	\$ 11,794	\$ —	\$ 11,794	\$ —	\$ 3,193
December 31, 2016	\$ 3,185,270	\$ 9,791	\$ —	\$ 9,791	\$ —	\$ 5,153

(A) Principal Outstanding is the aggregate principal of the underlying loans held by the securitization trusts.

(B) Assets on Balance Sheet and Maximum Exposure to Loss is the estimated fair value of securities issued by the entity and recorded as marketable securities, current in the consolidated balance sheets.

Note 7. Goodwill and Intangible Assets

December 31, 2017 (in thousands)

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Indefinite-lived assets			
Goodwill	\$ 8,205	\$ —	\$ 8,205
Tradenames	1,147	—	1,147
	<u>\$ 9,352</u>	<u>\$ —</u>	<u>\$ 9,352</u>
Finite-lived assets			
Customer relationships	6,895	410	6,485
Non-compete agreement	627	87	540
	<u>\$ 7,522</u>	<u>\$ 497</u>	<u>\$ 7,025</u>

Year Ended December 31, 2017

Goodwill activity (in thousands):	
Balance, December 31, 2016	\$ —
Goodwill recorded in connection with the HCS Acquisition	12,705
Impairment charge	(4,500)
Balance, December 31, 2017	<u>\$ 8,205</u>

During the fourth quarter of 2017, HCS was notified that a customer was significantly reducing the level of staff outsourced to HCS. The last pay period in 2017 was the final service period for these employees. This customer represented more than 20% of the Company's service fee income during 2017. Accordingly, management completed a goodwill impairment assessment as of December 31, 2017, determined that the carrying value of the HCS goodwill exceeded the fair value by \$4.5 million and recorded a goodwill impairment charge for the year ended December 31, 2017. Management assessed the other indefinite and definite lived intangible assets and determined no impairment existed as of December 31, 2017.

Amortization expense (in thousands)	
2017	\$ 496
Estimated amortization expense (in thousands)	
2018	1,194
2019	1,194
2020	1,107
2021	985
2022	985
Thereafter	1,560
Total estimated amortization expense	<u>\$ 7,025</u>

Note 8. Borrowings

Revolving Credit Agreement. As of December 31, 2017, HCS had \$3.3 million outstanding under a Revolving Credit and Security Agreement (the “FNCC Credit Agreement”) between HCS and Federal National Payables, Inc. (d/b/a Federal National Commercial Credit) (“FNCC”) providing HCS with a line of credit of up to \$5,000,000. Availability under the FNCC Credit Agreement is based on a formula tied to HCS’s eligible accounts receivable. Borrowings, and borrowings under the FNCC Credit Agreement bear interest at the prime rate plus 1.25%. The FNCC Credit Agreement also provides for customary origination and collateral monitoring fees payable to FNCC during its term. The initial term of the FNCC Credit Agreement expires on November 17, 2018, but it will be renewed automatically for consecutive one-year terms thereafter unless the FNCC Credit Agreement is terminated pursuant to its terms. The obligations of HCS under the FNCC Credit Agreement are secured by HCS’s inventory and accounts receivable.

The FNCC Credit Agreement contains customary representations, warranties and affirmative and negative covenants, including but not limited to financial covenants. The FNCC Credit Agreement also contains customary events of default, including but not limited to payment defaults, cross defaults with certain other indebtedness, breaches of covenants and bankruptcy events. In the case of an event of default, FNCC may, among other remedies, accelerate payment of all obligations under the FNCC Credit Agreement. In connection with the FNCC Credit Agreement, the Company executed a guaranty in favor of FNCC guaranteeing all of HCS’s obligations under the FNCC Credit Agreement.

Note Refinancing and 2017 Notes. Prior to the third quarter of 2017, the Company had outstanding three series of unsecured 2011 Notes pursuant to three separate “Indentures” with an aggregate principal balance of \$85.9 million. On July 27, 2017, the Company entered into a Senior Secured Note Purchase Agreement, dated as of the same date (the “Note Purchase Agreement”), with NHI and HCS as guarantors (together with the Company, collectively, the “Credit Parties”), the Noteholders and Wilmington Savings Fund Society, FSB, as collateral agent for the benefit of the Noteholders, to refinance \$85.9 million of principal indebtedness of the Company under the 2011 Notes. Pursuant to the Note Purchase Agreement, the Noteholders exchanged their 2011 Notes for new notes from the Company in the same aggregate principal amount (collectively, the “2017 Notes”) on the terms and conditions set forth therein.

Pursuant to the Note Purchase Agreement, in connection with the Note Refinancing, the Company paid all overdue and unpaid accrued interest on the 2011 Notes in the agreed, reduced aggregate amount of \$5.8 million, and paid \$0.5 million in fees and expenses incurred by the Noteholders.

The unpaid principal amounts of the 2017 Notes bear interest at a variable rate equal to LIBOR plus 3.5% per annum, payable quarterly in arrears until maturity on March 30, 2033. The 2017 Notes generally rank senior in right of payment to any existing or future subordinated indebtedness of the Credit Parties. The Company may at any time upon 30 days’ notice to the Noteholders redeem all or part of the 2017 Notes at a redemption price equal to 101% of the principal amount redeemed plus any accrued and unpaid interest thereon.

The Note Purchase Agreement contains customary affirmative and negative covenants, including but not limited to certain financial covenants. The Note Purchase Agreement also contains customary events of default, including but not limited to payment defaults, cross defaults with certain other indebtedness, breaches of covenants and bankruptcy events. In the case of an event of default, the Noteholders may, among other remedies, accelerate the payment of all obligations under the Note Purchase Agreement and the 2017 Notes. The Credit Parties entered into a Pledge and Security Agreement, dated as of the same date, pursuant to which each of the Credit Parties granted a first priority lien generally covering all of its assets, other than accounts receivable and inventory, for the benefit of the Noteholders, to secure the obligations under the Note Purchase Agreement and the 2017 Notes.

Property Financing. HCS financed the acquisition of property used in its operations under two separate financing agreements. The total amount financed under the agreements was \$1.3 million at an aggregate nominal interest rate of 4.1%. The total

amount outstanding under these loans was \$0.6 million as of December 31, 2017 of which \$0.4 million was current and is included in other current liabilities.

Note 9. Commitments and Contingencies

Contingencies. Prior to 2016, the Company originated, purchased, securitized, sold, invested in and serviced residential nonconforming mortgage loans and mortgage securities. The Company has received indemnification and loan repurchase demands with respect to alleged violations of representations and warranties (“defects”) and with respect to other alleged misrepresentations and contractual commitments made in loan sale and securitization agreements. These demands have been received substantially beginning in 2006 and have continued into recent years. Prior to the Company ceasing the origination of loans in its mortgage lending business, it sold loans to securitization trusts and other third parties and agreed to repurchase loans with material defects and to otherwise indemnify parties to these transactions. Beginning in 1997 and ending in 2007, affiliates of the Company sold loans to securitization trusts and third parties with the potential of such obligations. The aggregate original principal balance of these loans was \$43.1 billion at the time of sale or securitization. The remaining principal balance of these loans is not available as these loans are serviced by third parties and may have been refinanced, sold or liquidated. Claims to repurchase loans or to indemnify under securitization documents have not been acknowledged as valid by the Company. In some cases, claims were made against affiliates of the Company that have ceased operations and have no or limited assets. The Company has not repurchased any loans or made any such indemnification payments since 2010.

Historically, repurchases of loans or indemnification of losses where a loan defect has been alleged have been insignificant and any future losses for alleged loan defects have not been deemed to be probable or reasonably estimable; therefore, the Company has recorded no reserves related to these claims. The Company does not use internal groupings for purposes of determining the status of these loans. The Company is unable to develop an estimate of the maximum potential amount of future payments related to repurchase demands because the Company does not have access to information relating to loans sold and securitized and the number or amount of claims deemed probable of assertion is not known nor is it reasonably estimated. Further, the validity of claims received remains questionable. Also, considering that the Company completed its last sale or securitization of loans during 2007, the Company believes that it will be difficult for a claimant to successfully validate any additional repurchase demands. Management does not expect that the potential impact of claims will be material to the Company's consolidated financial statements.

Pending Litigation. The Company is a party to various legal proceedings. Except as set forth below, these proceedings are of an ordinary and routine nature. Any legal fees associated with these proceedings are expensed as incurred.

Although it is not possible to predict the outcome of any legal proceeding, in the opinion of management, other than the active proceedings described in detail below, proceedings and actions against the Company should not, individually, or in the aggregate, have a material effect on the Company's financial condition, operations and liquidity. Furthermore, due to the uncertainty of any potential loss as a result of pending litigation and due to the Company's belief that an adverse ruling is not probable, the Company has not accrued a loss contingency related to the following matters in its consolidated financial statements. However, a material outcome in one or more of the active proceedings described below could have a material impact on the results of operations in a particular quarter or fiscal year. See Note 2 to the consolidated financial statements for a description of the impact of the Company's Chapter 11 case on these proceedings.

On May 21, 2008, a purported class action case was filed in the Supreme Court of the State of New York, New York County, by the New Jersey Carpenters' Health Fund, on behalf of itself and all others similarly situated. Defendants in the case included NovaStar Mortgage Funding Corporation (“NMFC”) and NovaStar Mortgage, Inc. (“NMI”), wholly-owned subsidiaries of the Company, and NMFC's individual directors, several securitization trusts sponsored by the Company (“affiliated defendants”) and several unaffiliated investment banks and credit rating agencies. The case was removed to the United States District Court for the Southern District of New York. On June 16, 2009, the plaintiff filed an amended complaint. The plaintiff seeks monetary damages, alleging that the defendants violated sections 11, 12 and 15 of the Securities Act of 1933, as amended, by making allegedly false statements regarding mortgage loans that served as collateral for securities purchased by the plaintiff and the purported class members. On August 31, 2009, the Company filed a motion to dismiss the plaintiff's claims, which the court granted on March 31, 2011, with leave to amend. The plaintiff filed a second amended complaint on May 16, 2011, and the Company again filed a motion to dismiss. On March 29, 2012, the court dismissed the plaintiff's second amended complaint with prejudice and without leave to replead. The plaintiff filed an appeal. On March 1, 2013, the appellate court reversed the judgment of the lower court, which had dismissed the case. Also, the appellate court vacated the judgment of the lower court which had held that the plaintiff lacked standing, even as a class representative, to sue on behalf of investors in securities in which plaintiff had not invested, and the appellate court remanded the case back to the lower court for further proceedings. On April 23, 2013 the plaintiff filed its memorandum with the lower court seeking a reconsideration of the earlier dismissal of plaintiff's claims as to five offerings in which plaintiff was not invested, and on February 5, 2015 the lower court granted plaintiff's motion for reconsideration and vacated its earlier dismissal. On March 8, 2017, the affiliated defendants and all other parties executed an agreement to settle the action, with the contribution of the affiliated defendants to the settlement fund being paid by their insurance carriers. The court certified a settlement class and granted preliminary approval to the settlement on May 10, 2017. One member of the settlement class objected to the settlement and sought a stay of the final settlement approval hearing on the ground that it did not receive notice of the settlement and had no opportunity to timely opt out of the class. After the court

rejected the motion for a stay, the objector filed an appeal and requested a stay of the district court proceedings pending disposition of the appeal. The court of appeals denied the temporary stay of the district court proceedings pending a decision on the objector's request for a stay. Assuming the settlement is approved and completed, which is expected, the Company will incur no loss. The Company believes that the affiliated defendants have meritorious defenses to the case and, if the settlement is not approved, expects them to defend the case vigorously.

On June 20, 2011, the National Credit Union Administration Board, as liquidating agent of U.S. Central Federal Credit Union, filed an action against NMFC and numerous other defendants in the United States District Court for the District of Kansas, claiming that the defendants issued or underwrote residential mortgage-backed securities pursuant to allegedly false or misleading registration statements, prospectuses, and/or prospectus supplements. On August 24, 2012, the plaintiff filed an amended complaint making essentially the same claims against NMFC. NMFC filed a motion to dismiss the amended complaint which was denied on September 12, 2013. The defendants had claimed that the case should be dismissed based upon a statute of limitations and sought an appeal of the court's denial of this defense. An interlocutory appeal of this issue was allowed, and on August 27, 2013, the Tenth Circuit affirmed the lower court's denial of defendants' motion to dismiss the plaintiff's claims as being time barred; the appellate court held that the Extender Statute, 12 U.S.C. §1787(b)(14) applied to plaintiff's claims. On June 16, 2014, the United States Supreme Court granted a petition of NMFC and its co-defendants for certiorari, vacated the ruling of the Tenth Circuit, and remanded the case back to that court for further consideration in light of the Supreme Court's decision in *CTS Corp. v. Waldburger*, 134 S. Ct. 2175 (2014). On August 19, 2014, the Tenth Circuit reaffirmed its prior decision, and on October 2, 2014 the defendants filed a petition for writ of certiorari with the Supreme Court, which was denied. On March 22, 2016, NMFC filed motions for summary judgment, and plaintiff filed a motion for partial summary judgment. Those motions remain pending. Given that plaintiff did not file a timely proof of claim in NMFC's bankruptcy case, the Company believes it is likely that the case will be dismissed. The Company and NMFC have meritorious defenses to the case and expects it to defend the case vigorously in the event it proceeds.

On February 28, 2013 the Federal Housing Finance Agency, as conservator for the Federal Home Loan Mortgage Corporation (Freddie Mac) and purportedly on behalf of the Trustee of the NovaStar Mortgage Funding Trust, Series 2007-1 (the "Trust"), a securitization trust in which the Company retains a residual interest, filed a summons with notice in the Supreme Court of the State of New York, County of New York against the Company and NMI. The notice provides that this is a breach of contract action with respect to certain, unspecified mortgage loans and defendants' failure to repurchase such loans under the applicable agreements. Plaintiff alleges that defendants, from the closing date of the transaction that created the Trust, were aware of the breach of the representations and warranties made and failed to give notice of and cure such breaches, and due to the failure of defendants to cure any breach, notice to defendants would have been futile. The summons with notice was not served until June 28, 2013. By letter dated June 24, 2013, the Trustee of the Trust forwarded a notice from Freddie Mac alleging breaches of representations and warranties with respect to 43 loans, as more fully set forth in included documentation. The 43 loans had an aggregate, original principal balance of about \$6.5 million. On August 19, 2013, Deutsche Bank National Trust Company, as Trustee, filed a complaint identifying alleged breaches of representations and warranties with respect to seven loans that were included in the earlier list of 43 loans. Plaintiff also generally alleged a trust-wide breach of representations and warranties by defendants with respect to loans sold and transferred to the trust. Plaintiff seeks specific performance of repurchase obligations; compensatory, consequential, recessionary and equitable damages for breach of contract; specific performance and damages for anticipatory breach of contract; indemnification (indemnification against NMI only) and damages for breach of the implied covenant of good faith and fair dealing. On October 9, 2013, the Company and NMI filed a motion to dismiss plaintiff's complaint. This motion to dismiss was withdrawn after plaintiff filed an amended complaint on January 28, 2014, and on March 4, 2014 the Company and NMI filed a motion to dismiss the amended complaint. By a Decision/Order dated November 30, 2017, the court granted in part and denied in part the motion to dismiss the amended complaint. The court dismissed all claims except for plaintiff's claim for damages for breach of contract, to the extent that claim is based on the Company's and NMI's alleged failure to notify plaintiff of allegedly defective loans, and plaintiff's claim for indemnification. The court denied the motion to dismiss these claims without prejudice to the Company's and NMI's right to file a new motion to dismiss in conformity with procedures to be established in coordinated proceedings before the court addressing similar claims against numerous defendants. Briefing of the indemnification issues is now underway. Given the stage of the litigation, the Company cannot provide an estimate of the range of any loss. The Company believes it has meritorious defenses to the case and expects to defend the case vigorously.

Note 10. Fair Value Accounting

Fair Value Measurements

The Company's valuation techniques are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1 – Valuations based on quoted prices in active markets for identical assets and liabilities.
- Level 2 – Valuations based on observable inputs in active markets for similar assets and liabilities, other than Level 1 prices, such as quoted interest or currency exchange rates for substantially the full term of the asset or liability.
- Level 3 – Valuations based on significant unobservable inputs that are supported by little or no market activity, such as discounted cash flow methodologies based on internal cash flow forecasts.

The following tables present for each of the fair value hierarchy levels, the Company's assets and liabilities which are measured at fair value on a recurring basis (in thousands):

	Fair Value	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2017				
Marketable securities, current	\$ 11,795	\$ 1	\$ —	\$ 11,794
December 31, 2016				
Marketable securities, current	\$ 9,943	\$ 152	\$ —	\$ 9,791
Marketable securities, non-current	26,545	26,545	—	—
	\$ 36,488	\$ 26,697	\$ —	\$ 9,791

Valuation Methods and Processes

When available, the Company determines the fair value of its marketable securities using market prices from industry-standard independent data providers. Market prices may be quoted prices in active markets for identical assets (Level 1 inputs) or pricing determined using inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs), such as yield curve, volatility factors, credit spreads, default rates, loss severity, current market and contractual prices for the underlying instruments or debt, broker and dealer quotes, as well as other relevant economic measures.

To the extent observable inputs are not available, as is the case with the Company's retained mortgage securities, the Company estimates fair value using present value techniques and generally does not have the option to choose other valuation methods for these securities. The methods and processes used to estimate the fair value of the Company's retained mortgage securities are discussed further below. There have been no significant changes to the Company's valuation techniques. Accordingly, there have been no material changes to the consolidated financial statements resulting from changes to our valuation techniques.

The Company's marketable securities are classified as available-for-sale and are reported at their estimated fair value with unrealized gains and losses reported in accumulated other comprehensive income. To the extent that the cost basis of the Company's marketable securities exceeds the fair value and the unrealized loss is considered to be other than temporary, an impairment charge is recognized and the amount recorded in accumulated other comprehensive income or loss is reclassified to earnings as a realized loss. The specific identification method is used in computing realized gains or losses.

Mortgage securities - available-for-sale. The Company's mortgage securities include traditional agency mortgage-backed securities, with valuations based on quoted prices in active markets for identical assets (Level 1). Additionally, mortgage securities include investments that were retained during the Company's lending and securitization process, conducted prior to 2016. For the retained mortgage securities, the Company maintains the right to receive excess interest and other cash flow generated through the mortgage loan securitization vehicle. The Company receives the difference between the interest on the mortgage loans and the interest paid to the securitization bondholders. The Company also owns overcollateralization ("OC") classes of various securitization trusts. These OC bonds represent the difference in the principal of the underlying mortgage loans compared to the bonds sold to third parties. This extra collateral serves as a cushion for losses that have and may occur in the underlying mortgage pool. The OC bonds may receive cash if and when it is determined that actual losses are less than expectations. As of December 31, 2017, the aggregate overcollateralization was \$27.0 million. The timing and amount of cash to be generated by the OC bonds is contingent upon the performance of the underlying mortgage loan collateral.

The independent loan servicer controls and manages the individual mortgage loans and therefore the Company has no control over the loan performance. Collectively, these mortgage securities are identified by the Company as "retained mortgage securities," in order to distinguish them from the Company's traditional agency mortgage-backed securities. Retained mortgage-backed securities are valued at each reporting date using significant unobservable inputs (Level 3) by discounting the expected cash flows. An independent valuation specialist has been engaged to assist management in estimating cash flows and values for the Company's mortgage securities. It is the Company's responsibility for the overall resulting valuation.

As discussed in Note 1, the Company sold a portion of its retained mortgage securities subsequent to December 31, 2017. The Company evaluated the market conditions and other factors existing at the time of the sale as compared to December 31, 2017 and determined that conditions were substantially the same as of the sale date and December 31, 2017. Therefore, as of December 31, 2017 the Company valued these securities at the price at which it was sold. However, the Company determined that it could not extrapolate that price to the other retained mortgage securities because the underlying assets and their performance are not substantially similar to that of the security that was sold. Therefore, the other mortgage securities have been valued as discussed below.

The critical assumptions used in estimating the value of the mortgage securities include market interest rates, rate and severity of default, prepayment speeds and how long the security will continue to provide cash flow. To determine the assumptions, the

Company and its independent valuation specialist rely primarily on historical mortgage loan performance and appropriate general economic indicators. The Company continuously reviews the assumptions used and monitors the efforts of the independent valuation specialist. The significant unobservable inputs used in preparing the fair value estimates are:

	As of December 31,	
	2017	2016
Weighted average:		
Loss severity	62.1%	49.6%
Default rate	2%	2.1%
Prepayment speed	13.5%	9.8%
Servicer's optional redemption date	None	None

The following table provides a reconciliation of the beginning and ending balances for the Company's retained mortgage securities – available-for-sale which are measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (in thousands):

	For the Year Ended December 31,	
	2017	2016
Balance, beginning of period	\$ 9,791	\$ 2,011
Increases (decreases) to mortgage securities – available-for-sale:		
Proceeds from paydowns of securities, net (A)	(51)	(75)
Mark-to-market value adjustment	2,054	7,855
Net increases (decreases) to mortgage securities – available-for-sale	<u>2,003</u>	<u>7,780</u>
Balance, end of period	<u>\$ 11,794</u>	<u>\$ 9,791</u>

(A) Cash received on mortgage securities with no cost basis was \$2.8 million and \$4.7 million during 2017 and 2016, respectively.

The following disclosure of the estimated fair value of financial instruments presents amounts that have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions or estimation methodologies could have a material impact on the estimated fair value amounts. The fair value of short-term financial assets and liabilities, such as service fees receivable, accounts payable and accrued expenses are not included in the following table as their fair value approximates their carrying value.

The estimated fair values of the Company's financial instruments are as follows as of December 31, 2017 and 2016 (in thousands):

	As of December 31,			
	2017		2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Marketable securities	<u>\$ 11,795</u>	<u>\$ 11,795</u>	<u>\$ 36,488</u>	<u>\$ 36,488</u>
Financial liabilities:				
Senior notes	<u>\$ 85,938</u>	<u>\$ 23,018</u>	<u>\$ 85,938</u>	<u>\$ 23,349</u>

For the items in the table above not measured at fair value in the consolidated balance sheets but for which the fair value is disclosed, the fair value has been estimated using Level 3 methodologies, based on significant unobservable inputs that are supported by little or no market activity, such as discounted cash flow calculations based on internal cash flow forecasts. No assets or liabilities have been transferred between levels during any period presented.

Senior Notes. The fair value is estimated by discounting future projected cash flows using a discount rate commensurate with the risks involved. The interest rate on the senior notes is three-month LIBOR plus 3.5% per annum until maturity in March 2033. The three-month LIBOR used in the analysis was projected using a forward interest rate curve.

Financial assets reported at fair value on a nonrecurring basis include the following (in thousands):

December 31, 2017

	Fair Value (Level 3)	Gains and (Losses)
Goodwill	\$ 8,205	\$ (4,500)

Activity during 2017 for Goodwill, the Company's only Level 3 asset, measured on a nonrecurring basis is included in the following table (in thousands):

Goodwill

Balance, December 31, 2016	\$ —
Goodwill recorded in connection with the HCS Acquisition	12,705
Impairment charge	(4,500)
Balance, December 31, 2017	\$ 8,205

See note 7 for additional information regarding the Company's Goodwill and Intangible Assets.

Note 11. Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net earnings (loss) available to common shareholders by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share include the effect of conversions of stock options and nonvested shares. The computations of basic and diluted earnings per share for 2017 and 2016 (dollars in thousands, except share and per share amounts) are as follows:

	For the Year Ended December 31,	
	2017	2016
Numerator:		
Net income (loss) from continuing operations	\$ (11,760)	\$ 3,247
Income (loss) from discontinued operations	895	1,966
Net income (loss)	\$ (10,865)	\$ 5,213
Denominator:		
Weighted average common shares outstanding – basic	92,800,392	91,905,941
Weighted average common shares outstanding – diluted:		
Weighted average common shares outstanding – basic	92,800,392	91,905,941
Stock options	—	—
Nonvested shares	—	—
Weighted average common shares outstanding – diluted	92,800,392	91,905,941
Basic earnings per share:		
Net income (loss) from continuing operations	\$ (0.13)	\$ 0.04
Income (loss) from discontinued operations	0.01	0.02
Net income (loss)	\$ (0.12)	\$ 0.06
Diluted earnings per share:		
Net income (loss) from continuing operations	\$ (0.13)	\$ 0.04
Income (loss) from discontinued operations	0.01	0.02
Net income (loss)	\$ (0.12)	\$ 0.06

The following weighted-average stock options to purchase shares of common stock were outstanding, but were not included in the computation of diluted earnings (loss) per share because the number of shares assumed to be repurchased, as calculated was greater than the number of shares to be obtained upon exercise, therefore, the effect would be antidilutive. There were no options granted during 2016 and 2017.

	For the Year Ended December 31,	
	2017	2016
Number of stock options	1,411	4,719
Weighted average exercise price of stock options	\$ 0.89	\$ 0.68

During 2016, the Company granted 0.1 million nonvested shares to a director and these shares vested in 2016. During 2017, the Company granted 4.3 million shares to directors, officers and other members of management. Substantially all of these shares will vest in 2018, assuming the grantees are employed at the vest date. As of December 31, 2017 and 2016, respectively, the Company had approximately 4.3 million and 0.1 million nonvested shares outstanding. The weighted average impact of 1.1 million and 0.9 million nonvested shares were not included in the calculation of earnings per share for 2017 and 2016, respectively, because they were anti-dilutive.

Note 12. Income Taxes

The components of income tax expense (benefit) from continuing operations are (in thousands):

	For the Year Ended December 31,	
	2017	2016
Current:		
Federal	\$ (1)	\$ (14)
State and local	15	(7)
Total current	<u>\$ 14</u>	<u>\$ (21)</u>

Below is a reconciliation of the expected federal income tax expense (benefit) using the federal statutory tax rate of 35% to the Company's actual income tax benefit and resulting effective tax rate (in thousands).

	For the Year Ended December 31,	
	2017	2016
Income tax (benefit) at statutory rate	\$ (3,802)	\$ 1,129
State income taxes, net of federal tax benefit	(54)	211
Valuation allowance	(131,234)	14,595
Change in federal tax rate	33,640	—
Change in state tax rate	100,899	(16,475)
Bankruptcy reorganization	746	437
Uncertain tax positions	(4)	(35)
Other	(177)	117
Total income tax expense (benefit)	<u>\$ 14</u>	<u>\$ (21)</u>

In 2017, the federal statutory rate for periods beginning after December 31, 2017 was changed to 21%. This change in rate caused a significant change to the Company's deferred tax assets as they pertain to its net operating losses ("NOLs"). The 2017 change in deferred tax assets related to the federal NOLs was \$100.9 million in the current year. This was offset by a decrease in the valuation allowance by \$100.9 million. Prior to 2016, the Company concluded that it was no longer more likely than not that it would realize a portion of its deferred tax assets. Therefore, the Company maintained a full valuation allowance against its net deferred tax assets as of both December 31, 2017 and 2016.

The Company's determination of the realizable deferred tax assets requires the exercise of significant judgment, based in part on business plans and expectations about future outcomes. In the event the actual results differ from these estimates in future periods, the Company may need to adjust the valuation allowance, which could materially impact our financial position and results of operations. The Company will continue to assess the need for a valuation allowance in future periods. As of December

31, 2017 and 2016, the Company maintained a valuation allowance of \$162.7 million and \$292.2 million, respectively, for its deferred tax assets.

In 2017, due to the purchase of HCS, the Company reassessed their state apportionment rates. Based on available information, the Company changed the apportionment factors, specifically the apportionment factor used for allocation of income to the State of Missouri. In this reassessment, the Company determined that as of December 31, 2017 it was no longer appropriate to apportion 100% of the Federal NOL to the state of Missouri, but rather the company would apportion approximately 13%. As a result of this reassessment, the Company recalculated the deferred tax assets which resulted in the reduction of the deferred tax asset related to state NOLs totaling approximately \$33.6 million in the current year. This was offset by a decrease in the valuation allowance of approximately \$33.6 million. Significant components of the Company's deferred tax assets and liabilities are (in thousands):

	December 31,	
	2017	2016
Deferred tax assets:		
Basis difference – investments	\$ 8,015	\$ 17,261
Federal NOL carryforwards	145,608	239,942
State NOL carryforwards	8,301	35,896
Other	2,756	2,816
Gross deferred tax asset	<u>164,680</u>	<u>295,915</u>
Valuation allowance	(162,708)	(292,214)
Deferred tax asset	<u>1,972</u>	<u>3,701</u>
Deferred tax liabilities:		
Other	<u>1,972</u>	<u>3,701</u>
Deferred tax liability	1,972	3,701
Net deferred tax asset	<u>\$ —</u>	<u>\$ —</u>

As of December 31, 2017, the Company had a federal NOL of approximately \$692.0 million, including \$307.3 million in losses on mortgage securities that have not been recognized for income tax purposes. The federal NOL may be carried forward to offset future taxable income, subject to applicable provisions of the Internal Revenue Code (the "Code"). If not used, these NOLs will expire in years 2025 through 2037. The Company has state NOL carryforwards arising from both combined and separate filings from as early as 2004. The state NOL carryforwards may expire as early as 2017 and as late as 2037.

The activity in the accrued liability for unrecognized tax benefits, included in other current liabilities, was (in thousands):

	For the Year Ended	
	December 31,	
	2017	2016
Beginning balance	\$ 331	\$ 368
Gross increases – tax positions in current period	22	2
Lapse of statute of limitations	(25)	(39)
Ending balance	<u>\$ 328</u>	<u>\$ 331</u>

As of December 31, 2017 and 2016, the total gross amount of unrecognized tax benefits was \$0.3 million, which also represents the total amount of unrecognized tax benefits that would impact the effective tax rate. The Company anticipates a reduction of unrecognized tax benefits of less than \$0.1 million due the lapse of statute of limitations in the next twelve months. The Company does not expect any other significant change in the liability for unrecognized tax benefits in the next twelve months. It is the Company's policy to recognize interest and penalties related to income tax matters in income tax expense. The benefit for interest and penalties recorded in income tax expense was not significant for 2017 and 2016. There were accrued interest and penalties of less than \$0.1 million as of both December 31, 2017 and 2016. The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of multiple state and local jurisdictions. Tax years 2013 to 2017 remain open to examination for both U.S. federal income tax and major state tax jurisdictions.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, our executive chairman and our chief financial officer conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based on their evaluation of our disclosure controls and procedures, our executive chairman and chief financial officer, with the participation of the Company's management, concluded that our disclosure controls and procedures were not effective as of December 31, 2017, to ensure that information required to be disclosed by the Company in the reports that we file or submit under the Exchange Act is (a) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (b) accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate to allow for timely decisions regarding required disclosure.

Management's Annual Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of consolidated financial statements for external purposes in accordance with GAAP. Under the supervision and with the participation of management, including the Company's principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting as of December 31, 2017 based on the framework set forth in Internal Control—Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation and its assessment, management concluded that the Company's internal control over financial reporting was not effective as of December 31, 2017.

Description of Material Weakness

As discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations above and in Note 4 to our accompanying consolidated financial statements, in July 2017, we acquired HCS, which now is our primary business activity. Prior to the HCS Acquisition, HCS was a privately-owned business with limited administrative and accounting resources, accounting software inappropriate for the size of the business and generally weak accounting processes, procedures and controls. Specifically, material weaknesses existed in HCS's processes, procedures and controls with respect to revenue, receivables, payment of payroll taxes and estimating various accrued expenses.

Remediation of Material Weakness

We are working to improve the processes, procedures and controls at HCS and remediate this material weakness. Since the HCS Acquisition in July 2017, we have implemented improvements in processes, procedures and controls and we will continue to do so. We are evaluating the accounting professionals at the Company and HCS and will determine if additional resources with relevant experience are needed. We will disclose in future periods the progress we have made in efforts to remediate this material weakness.

Changes in Internal Control Over Financial Reporting

As a result of the HCS acquisition and the generally weak controls at HCS discussed above, we determined that we have a material weakness in our disclosure controls and procedures and internal control over financial reporting. We are working to remediate this material weakness as discussed above.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. In designing and operating a control system, one must consider the potential benefits of controls relative to their costs and the reality of limited resources available to allocate to control activities, particularly in smaller companies. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events and there can be no assurance that any control will meet its objectives under all potential future conditions. Because of such inherent limitations in any control system, there can be no absolute assurance that control issues, misstatements, and/or fraud will be prevented or detected.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

DIRECTORS AND EXECUTIVE OFFICERS

Howard M. Amster, age 70, has been a member of the Board since 2009. Mr. Amster currently is an owner and operator of multiple real estate investments. Since March 1998, Mr. Amster has served as President of Pleasant Lake Apts. Corp., the corporate general partner of Pleasant Lake Apts. Limited Partnership. Mr. Amster also serves as a director of Maple Leaf Financial, Inc., the holding company for Geauga Savings Bank, and newAX, Inc. (formerly Astrex, Inc.). Since June 2015, Mr. Amster also has served as a Financial Advisor at McDonald Partners, LLC, a securities brokerage firm. From 2000 to May 2015, Mr. Amster served as a Principal with Ramat Securities Ltd., a securities brokerage firm. From 1992 to 2000, Mr. Amster was an investment consultant with First Union Securities (formerly EVEREN Securities and formerly Kemper Securities). The Board believes Mr. Amster's qualifications to serve on the Board include his investment experience and his service as a director of public companies.

Charles M. Gillman, age 48, has been a member of the Board since January 2016. Mr. Gillman is the head of the IDWR Multi-Family Office ("IDWR"), a position he has held since 2013. IDWR employs a team of analysts with expertise in finding publicly traded companies that require operational enhancement and an improvement in corporate capital allocation. From 2001 to 2013, Mr. Gillman was a portfolio manager of certain family office investment portfolios at Nadel and Gussman, LLC. Prior to his employment at Nadel and Gussman, Mr. Gillman worked in the investment industry and as a strategic management consultant at McKinsey & Company, where he gained experience designing operational turnarounds of U.S. and international companies. Mr. Gillman currently serves on the board of directors of Points International, Digirad and Solitron. Mr. Gillman is a Summa Cum Laude graduate of the Wharton School and a Director of the Penn Club of New York which serves as the Manhattan home of the Wharton and Penn alumni community. The Board believes that Mr. Gillman's qualifications to serve on the Board include his significant experience as a successful portfolio manager, M&A experience and divestiture experience.

Barry A. Igdaloff, age 63, has been a member of the Board since 2009. Mr. Igdaloff served as the sole proprietor of Rose Capital, a registered investment advisor in Columbus, Ohio, since 1995. Mr. Igdaloff has been a director of Dynex Capital, Inc. since 2000. Previously, Mr. Igdaloff was a director of Guest Supply, Inc. prior to its acquisition by Sysco Foods in 2001. Prior to entering the investment business, Mr. Igdaloff was an employee of Ernst & Whinney's international tax department. Mr. Igdaloff is a non-practicing CPA and a non-practicing attorney. The Board believes Mr. Igdaloff's qualifications to serve on the Board include his financial expertise, his years of experience as an investment advisor, attorney, and CPA and his service as a director of public companies.

Robert G. Pearse, age 58, has been a member of the Board since April 2015. Mr. Pearse currently serves as a Managing Partner at Yucatan Rock Ventures, where he specializes in technology investments and consulting, and has served in that position since August 2012. Mr. Pearse serves as a director for Ameri Holdings, Inc. (OTC:AMRH), Chairman of the Compensation Committee and member of the Audit Committee since May 2015. Previously, Mr. Pearse served as Chairman of the Board of directors for Crossroads Systems, Inc. (NASDAQ:CRDS) from May 2016 to October 2017, and chairman of the Compensation Committee and member of the Audit Committee and the Nomination and Governance Committee from July 2013 to October 2017. Mr. Pearse served as a director for Aviat Networks, Inc. (NASDAQ:AVNW), and member of the Compensation Committee and the Nominating and Governance Committee from January 2015 to November 2016. From 2005 to 2012, Mr. Pearse served as vice president of Strategy and Market Development at NetApp, Inc. (NASDAQ:NTAP), a computer storage and data management company. From 1987 to 2004, Mr. Pearse held leadership positions at Hewlett-Packard Inc. (NYSE:HPQ), most recently as the vice president of Strategy and Corporate Development from 2001 to 2004. Mr. Pearse's professional experience also includes positions at PricewaterhouseCoopers LLP, Eastman Chemical Company (NYSE:EMN), and General Motors Company (NYSE:GM). Mr. Pearse earned a Master of Business Administration degree from the Stanford Graduate School of Business in 1986, and a Bachelor of Science degree in Mechanical Engineering from the Georgia Institute of Technology in 1982. The Board believes Mr. Pearse's qualifications to serve on the Board include his extensive business development and financial expertise.

David W. Pointer, age 48, has been our Chief Executive Officer and Chairman of the Board since March 27, 2018. He has served as the Managing Partner of V.I. Capital Management, LLC, a registered investment advisory firm that he founded, since January 2008. Prior to that, Mr. Pointer was a Senior Portfolio Manager and Senior Vice President at ICM Asset Management, an employee owned investment manager, from September 2003 to September 2007, as well as Portfolio Manager at AIM/INVESCO Investments, an investment management firm, from July 1999 to August 2003. Mr. Pointer has served on the Board of Directors of CompuMed, Inc., an enterprise telemedicine solutions company, since December 2013 and as Chairman since October 2014, and as Co-Chief Executive Officer from November 2015 to January 2016. He also has served on the Board of Directors of Solitron Devices, Inc., a manufacturer of solid-state semiconductor components, since August 2015 and as Chairman since July 2016. Previously, Mr. Pointer served on the Board of Directors of ALCO Stores, Inc., a retailer, from September 2014 to June 2015. Mr. Pointer has taught Corporate Finance as an adjunct faculty in Whitworth University's MBA program as well as Gonzaga University's MBA program and is an expert in financial analysis and financial markets. Mr. Pointer holds a Bachelor of Science in Business Administration from Central Washington University and a Master of Business

Administration from the Wharton School of Business at the University of Pennsylvania. Mr. Pointer is a member of the CFA Institute and a Chartered Financial Analyst.

Carolyn K. Campbell, age 47, has served as our Chief Financial Officer since August 2017. She previously worked as an independent contractor in internal audit and tax roles for various businesses from July 2016 to August 2017. From 2007 to March 2016, Ms. Campbell served as the Company's Internal Audit Manager and was responsible for overseeing corporate audit processes and developing and implementing risk-based audit plans and internal controls over financial recordkeeping and reporting. From 2001 to 2004, Ms. Campbell was an internal auditor with Butler Manufacturing Company, a construction engineering company. From 1995 to 2001, Ms. Campbell was employed by Houlihan's Restaurant Group, a developer of restaurant concepts, most recently as a tax analyst. Ms. Campbell holds a Bachelor of Science in Business Administration from the University of Central Missouri.

Richard M. Rector, age 61, is the President of HCS. Mr. Rector has more than 30 years of experience in Staffing and Business Management of mid-size to large businesses. Prior to joining HCS in October 2015, Mr. Rector was Executive Vice President and Co-Owner of an international modernization and staffing company for ten years. Before that, he served as a Regional Manager for two mid-sized companies in the staffing industry. He has extensive experience in business administration, staffing, operations, and automation. Mr. Rector has a Bachelor of Business Administration in Administrative Management and Marketing from the University of North Texas.

CORPORATE GOVERNANCE AND RELATED MATTERS

Board Leadership Structure

The Board is led by Mr. Pointer, the Company's Chief Executive Officer and Chairman of the Board, and by Mr. Igdaloff, who serves as the Company's Lead Independent Director having such responsibilities set forth in the Company's Corporate Governance Guidelines. The Board has determined that this leadership structure is in the best interests of the Company's shareholders at this time.

Board and Committee Meetings

During 2017, there were 4 meetings of the Board, 2 meetings of the Audit Committee, 2 meetings of the Compensation Committee and no meetings of the Nominating and Corporate Governance Committee, in addition to actions taken by unanimous written consent. Each director participated in at least 75% of the meetings of the Board and the committees on which he served during the periods for which he has been a director or committee member. We have no written policy regarding director attendance at our annual meetings of shareholders.

Board Committees

The Board has a standing Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee. The Board has determined that all directors serving on the Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee are independent with the meaning of SEC and NASDAQ rules. Descriptions of the responsibilities of such committees are provided below. These descriptions are qualified in their entirety by the full text of the written committee charters that may be found on the Company's website at www.novationcompanies.com.

Audit Committee. The responsibilities of the Audit Committee are set forth in its charter and include assisting the Board in fulfilling its oversight responsibility relating to: (i) the integrity of the Company's consolidated financial statements and financial reporting process and its system of internal accounting and financial controls; (ii) the performance of the internal audit function; (iii) the performance of the independent auditors, which would include an evaluation of the independent auditor's qualifications and independence; (iv) the Company's compliance with legal and regulatory requirements, including disclosure controls and procedures; and (v) the preparation of an Audit Committee report to be included in the Company's annual proxy statement. The Audit Committee consists of Barry A. Igdaloff, Howard M. Amster, and Robert G. Pearse, with Mr. Igdaloff serving as the chairman. The Board has determined that Barry A. Igdaloff and Robert G. Pearse qualify as "audit committee financial experts" under SEC rules and that each Audit Committee member has sufficient knowledge in reading and understanding the Company's consolidated financial statements to serve on the Audit Committee.

Nominating and Corporate Governance Committee. The responsibilities of the Nominating and Corporate Governance Committee are set forth in its charter and include the following: (i) identify individuals qualified to become Board members consistent with the criteria established by the Board; (ii) recommend to the Board the director nominees for the next annual meeting of shareholders; (iii) lead the Board in the annual review of the Board's performance and the review of management's performance; and (iv) shape the corporate governance policies and practices including developing a set of corporate governance principles applicable to the Company and recommending them to the Board. The Nominating and Corporate Governance Committee consists of Barry A. Igdaloff, Howard M. Amster and Robert G. Pearse, with Mr. Igdaloff serving as the chairman.

Compensation Committee. The responsibilities of the Compensation Committee are set forth in its charter and include the following: (i) review and approve the goals, objectives and compensation structure for our Chief Executive Officer, Chief Financial Officer and senior management; (ii) review, approve and recommend to the Board any new incentive-compensation and equity-based plans that are subject to Board approval; and (iii) approve any required disclosure on executive officer compensation for inclusion in the Company's annual proxy statement and Annual Report on Form 10-K. The Compensation Committee consists of Robert G. Pearse, Howard M. Amster and Charles M. Gillman, with Mr. Pearse serving as the chairman.

Compensation Committee Process and Advisors

The Compensation Committee is responsible for discharging the responsibilities of the Board with respect to the compensation of our executive officers. The Compensation Committee recommends overall compensation of our executive officers to the Board. The Board approves all compensation of our executive officers. The Compensation Committee may form and delegate authority to subcommittees, comprised of one or more members of the Compensation Committee, as necessary or appropriate, and each such subcommittee shall have the full power and authority of the Compensation Committee.

The charter of the Compensation Committee permits the Compensation Committee to engage outside consultants. In 2017, the Compensation Committee did not retain a compensation consultant.

Corporate Governance Documents

The Company's Corporate Governance Guidelines, Code of Conduct, and the charters of the Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee are available at the Investors-Corporate Governance section of our website, www.novationcompanies.com. The Company will also provide copies of these documents free of charge to any shareholder who sends a written request to: Novation Companies, Inc., Investor Relations, 500 Grand Boulevard, Suite 201B, Kansas City, MO 64106.

Code of Ethics

The Company has adopted a Code of Conduct that applies to our directors, principal executive officer, principal financial officer, principal accounting officer, and other employees. The Code of Conduct is available at the Investors-Corporate Governance section of our website, www.novationcompanies.com. We intend to satisfy the disclosure requirements regarding any amendment to, or waiver from, a provision of our Code of Conduct that applies to our principal executive officer, principal financial officer, principal accounting officer, controller or persons performing similar functions by disclosing such matters on our website within four business days.

Our investor relations contact information follows:

Investor Relations
500 Grand Boulevard, Suite 201B
Kansas City, Missouri 64106
816.237.7000
Email: ir@novationcompanies.com

Shareholder Communications with the Board

Shareholders may communicate directly with any member of the Board or any individual chairman of a Board committee by writing directly to those individuals at the following address: Novation Companies, Inc., 500 Grand Boulevard, Suite 201B, Kansas City, MO 64106. Communications that are intended for the non-management, independent directors generally should be marked to the attention of the chairman of the Nominating and Corporate Governance Committee. The Company's general policy is to forward, and not to intentionally screen, any substantive mail received at the Company's corporate office that is sent directly to a director; however, (i) routine advertisements and business solicitations and (ii) communications deemed to be a security risk or principally for harassment purposes, may not be forwarded in the discretion of the Corporate Secretary, provided that in the latter case the Chairman of the Board is notified thereof.

Risk Oversight

The Board oversees an enterprise-wide approach to risk management, designed to support the achievement of Company objectives, improve long-term Company performance and create shareholder value. A fundamental part of risk management is understanding the risks the Company faces and what steps management is taking to manage those risks, but also understanding what level of risk is appropriate for the Company. The involvement of the full Board in setting the Company's business strategy and objectives is integral to the Board's assessment of the Company's risk and also a determination of what constitutes an appropriate level of risk for the Company. The full Board conducts an annual risk assessment of the Company's financial risk, legal/compliance risk and operational/strategic risk and addresses individual risk issues throughout the year as necessary.

While the Board has the ultimate oversight responsibility for the risk management process, the Board delegates responsibility for certain aspects of risk management to the Audit Committee. Per its charter, the Audit Committee focuses on key financial risks and related controls and processes and discusses with management the Company's major financial reporting exposures and the steps management has taken to monitor and control such exposures.

The Board believes its leadership structure enhances overall risk oversight. While the Board requires risk assessments from management, the combination of Board member experience, diversity of perspectives, continuing education and independence of governance processes provide an effective basis for testing, overseeing and supplementing management assessments.

Identifying and Evaluating Nominees for Directors

The Nominating and Corporate Governance Committee utilizes a variety of methods for identifying and evaluating nominees for director. The Nominating and Corporate Governance Committee regularly assesses the appropriate size of the Board, and whether any vacancies on the Board are expected due to retirement or otherwise. In the event that vacancies are anticipated, or otherwise arise, the Nominating and Corporate Governance Committee considers various potential candidates for director. Candidates may come to the attention of the Nominating and Corporate Governance Committee through current members of the Board, professional search firms, shareholders or other persons. These candidates are evaluated at regular or special meetings of the Nominating and Corporate Governance Committee, and may be considered at any point during the year. Shareholder nominations should be addressed to: Novation Companies, Inc., 500 Grand Boulevard, Suite 201B, Kansas City, MO 64106, attention Corporate Secretary. The Nominating and Corporate Governance Committee will consider properly submitted shareholder nominations for candidates for the Board, following verification of the shareholder status of persons proposing candidates. If any materials are provided by a shareholder in connection with the nominating of a director candidate, such material will be forwarded to the Nominating and Corporate Governance Committee. The Nominating and Corporate Governance Committee will also review materials provided by professional search firms or other parties.

The Nominating and Corporate Governance Committee considers candidates for the Board based upon several criteria set forth in the Company's Corporate Governance Guidelines, including their broad-based business and professional skills and experience, education, accounting and financial expertise, age, reputation, civic and community relationships, concern for the long-term interest of shareholders, personal integrity and judgment, knowledge and experience in the Company's industry (such as operations, finance, accounting and marketing experience and education) and diversity. The Nominating and Corporate Governance Committee considers diversity in the broadest sense, thus including factors such as age, gender, race, ethnicity and geographic location, as well as a variety of experience and educational backgrounds when seeking nominees to the Board. The Nominating and Corporate Governance Committee does not have a formal diversity policy in place.

The Nominating and Corporate Governance Committee does not assign specific weights to the criteria and no particular criterion is necessarily applicable to all prospective nominees. When evaluating nominees, the composition of the entire Board is also taken into account, including the need for a majority of independent directors. In addition, the assessment of a candidate includes consideration of the number of public boards on which he or she serves because of the time requirements for duties and responsibilities associated with serving on the Board. The Nominating and Corporate Governance Committee believes that the backgrounds and qualifications of the directors, considered as a group, should provide a significant composite mix of experience, knowledge and abilities that will allow the Board to fulfill its responsibilities. The Nominating and Corporate Governance Committee assesses the effectiveness of the Corporate Governance Guidelines, including with respect to director nominations and qualifications and achievement of having directors with a broad range of experience and backgrounds, through completion of the annual self-evaluation process.

Involvement in Certain Legal Proceedings

Company director Charles M. Gillman is subject to an SEC administrative order, dated February 14, 2017 (Securities Exchange Act Release No. 80038), relating to alleged violations of Section 13(d) of the Exchange Act and the rules promulgated thereunder, including failing to disclose the members of a stockholder group, and further allegations that he violated Section 16(a) of the Exchange Act and the rules promulgated thereunder, including failing to timely file initial statements of beneficial ownership on Form 3 and changes thereto on Form 4. Without admitting or denying any violations, Mr. Gillman agreed to cease and desist from committing or causing any violations of (i) Section 13(d) of the Exchange Act and Rules 13d-1 and 13d-2 promulgated thereunder and (ii) Section 16(a) of the Exchange Act and Rules 16a-2 and 16a-3 promulgated thereunder, and paid a civil penalty to the SEC in the amount of \$30,000.

V.I. Capital Management, LLC ("V.I. Capital") and Chief Executive Officer and Chairman of the Board David W. Pointer are subject to a consent order (the "Consent Order") from the State of Washington Department of Financial Institutions, Securities Division, dated March 12, 2018 (Order Number S-16-2093-17-CO01), relating to alleged breaches of their fiduciary duty as investment advisors to their clients, including (i) failure to disclose certain conflict of interest stemming from Mr. Pointer's service on the Boards of Directors of CompuMed, Inc. and Solitron Devices, Inc., (ii) pledging V.I. Capital investment fund assets as collateral for a line of credit for CompuMed, Inc. and failing to disclose such pledge to V.I. Capital's year-end auditor, and (iii) failure to timely distribute audited financial statements and a final fund audit to investors. As conditions of the Consent Order, V.I. Capital and Mr. Pointer agreed to (i) cease and desist from violating the Securities Act of 1933, (ii) pay a fine of \$10,000 and (iii) pay costs of \$2,500. Mr. Pointer also agreed that he will not be a principal, officer or owner of an investment

adviser or broker-dealer for 10 years following the entry of the Consent Order, but he may apply for a securities salesperson or investment adviser representative registration with an acceptable plan of supervision.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our directors and executive officers, and holders of more than 10% of our common stock, to file with the SEC initial reports of ownership and reports of changes in ownership of common stock and other equity securities of the Company. Such persons are required by SEC regulations to furnish us with copies of all Section 16(a) forms they file. Based solely upon a review of the copies of the forms furnished to us and written representations made by our directors and officers, we believe that our directors, officers and holders of more than 10% of our common stock complied with all applicable filing requirements during fiscal year 2017, except that Messrs. Eberwein and Igdaloff each filed a Form 4 on December 18, 2017, reporting a transaction that occurred on December 13, 2017, and Mr. Rector filed a Form 4 on August 2, 2017, reporting a transaction that occurred on July 27, 2017.

Item 11. Executive Compensation

DIRECTOR COMPENSATION

The following table presents a summary of the compensation earned by each director who served on the Board during the fiscal year ended December 31, 2017, other than our former Executive Chairman Mr. Eberwein, whose compensation is described in the Executive Compensation section below:

Name and Principal Position	Fees earned or paid in cash (\$)	Stock Awards (\$) ⁽¹⁾	Total (\$)
Barry A. Igdaloff	\$ 21,411	\$25,000	\$ 46,411
Howard M. Amster	8,921	25,000	33,921
Charles M. Gillman	8,921	25,000	33,921
Robert G. Pearse	11,598	25,000	36,598

(1) Represents the aggregate grant date fair value computed in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 718.

On August 23, 2017, the Board approved base compensation for each of the Company's non-employee directors, Barry A. Igdaloff, Howard M. Amster, Charles M. Gillman and Robert G. Pearse, in an amount of \$50,000 per annum, including (i) \$25,000 in restricted stock awards, vesting on the first anniversary of the grant date, and (ii) \$25,000 in cash, payable on a quarterly basis. The Board approved additional compensation for the chairmen of the Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee and the Lead Independent Director in the amounts of \$10,000, \$7,500, \$5,000 and \$20,000, respectively, in cash, payable on a quarterly basis. In order to satisfy the foregoing compensation, on the same date, the Compensation Committee granted to each of the non-employee directors a \$25,000 restricted stock award, which vests on the first anniversary of the grant date, pursuant to the terms and conditions of the 2015 Incentive Plan and each director's respective award agreement, as a component of such director's base compensation.

On December 12, 2017, the Compensation Committee approved one-time additional compensation of \$25,000 in cash and 357,143 shares of restricted stock for Mr. Igdaloff in recognition of his considerable time and effort in connection with the Company's successful emergence from bankruptcy. These restricted stock awards vest one year from the grant date.

EXECUTIVE COMPENSATION

Our named executive officers during 2017 (each a "Named Executive Officer") were (i) Carolyn K. Campbell, our Chief Financial Officer, (ii) Richard M. Rector, President of HCS, (iii) Jeffrey E. Eberwein, our former Executive Chairman and (iv) Rodney E. Schwatken, our former Chief Executive Officer, Chief Financial Officer and Treasurer.

Summary Compensation Table

The following table sets forth the compensation of our Named Executive Officers for the periods indicated.

Name and Principal Position	Year	Salary	Bonus	Stock	All Other	Total
				Awards ⁽¹⁾	Compensation	
Carolyn K. Campbell ⁽²⁾ <i>Chief Financial Officer</i>	2017	\$ 43,934	\$ —	\$ 15,750	\$ —	\$ 59,684
Richard M. Rector ⁽³⁾ <i>President, Healthcare Staffing, Inc.</i>	2017	101,923	35,000	97,000	6,720	240,643
Jeffrey E. Eberwein ⁽⁴⁾ <i>Former Executive Chairman</i>	2017	41,369	25,000	75,000	—	141,369
Rodney E. Schwatken ⁽⁵⁾ <i>Former Chief Executive Officer and Chief Financial Officer</i>	2017	289,904	—	42,400	—	332,304
	2016	300,000	—	—	—	300,000

(1) Represents the aggregate grant date fair value computed in accordance with FASB ASC Topic 718.

(2) Ms. Campbell was appointed Chief Financial Officer on August 14, 2017.

(3) Compensation for Mr. Rector is presented beginning on July 27, 2017, the date of the HCS Acquisition. Other compensation includes a payment to Mr. Rector for his buyout of accrued paid time off pursuant to the HCS paid time off policy.

(4) Mr. Eberwein resigned from his position as our Executive Chairman effective March 27, 2018.

(5) Mr. Schwatken resigned from his position as our Chief Executive Officer effective October 1, 2017.

Outstanding Equity Awards at Fiscal Year-End 2017

The following table sets forth equity incentive plan awards for each of our Named Executive Officers outstanding as of December 31, 2017. There were no outstanding stock options for our Named Executive Officers as of December 31, 2017.

Name	Stock Awards	
	Number of shares or units of stock that have not vested	Market value of shares or units of stock that have not vested ⁽¹⁾
Carolyn K. Campbell ⁽²⁾	150,000	\$ 10,050
Richard M. Rector ⁽³⁾	1,000,000	67,000
Jeffrey E. Eberwein ⁽⁴⁾	1,071,429	71,786

(1) Based on the closing share price on December 29, 2017 of \$0.067.

(2) Shares of restricted stock granted under the 2015 Incentive Stock Plan. 100% of these shares vest on September 1, 2018, subject to continuous employment with Novation through the vesting date.

(3) Shares of restricted stock granted under the 2015 Incentive Stock Plan. 40% of these shares vest on July 27, 2018, 35% of these shares vest on July 27, 2019 and 25% of these shares vest on July 27, 2020, subject to continuous employment with HCS through each applicable vesting date.

(4) Shares of restricted stock granted under the 2015 Incentive Stock Plan. 100% of these shares were forfeited to the Company as of March 31, 2018, upon Mr. Eberwein's resignation as a director.

Employment Agreements and Arrangements with Named Executive Officers

Carolyn K. Campbell

Ms. Campbell entered an employment agreement with the Company on August 9, 2017 (the "Campbell Employment Agreement"). Ms. Campbell's base salary is \$150,000, and she is eligible to participate in any equity programs of the Company, at the Company's discretion. The Campbell Employment Agreement has an indefinite term and provided that Ms. Campbell is an employee "at-will," and her employment may be terminated at any time by either party, with or without cause, for any reason or no reason. If Ms. Campbell's employment is terminated by the Company other than for "cause" or by Ms. Campbell for "good reason" (each as defined in the Campbell Employment Agreement), Ms. Campbell will receive, over a period of 3 months following termination, compensation at an annual rate equal to her then-existing annual base salary.

Richard M. Rector

Mr. Rector entered an employment agreement with the Company and HCS on July 27, 2017 (the "Rector Employment Agreement"). Mr. Rector's base salary is \$225,000, and he is eligible to earn a quarterly bonus, based on the Company's EBITA achievement, and to participate in the Company's 2015 Incentive Stock Plan. The Rector Employment Agreement also provides for a grant of 1,000,000 restricted shares of the Company's common stock pursuant to the terms of the Rector Employment Agreement and the Company's 2015 Incentive Stock Plan. The Rector Employment Agreement has an indefinite term and provides that Mr. Rector is an employee "at-will," and his employment may be terminated at any time by either party, with or

without cause, for any reason or no reason. If Mr. Rector's employment is terminated by the Company other than for "cause" or by Mr. Rector for "good reason" (each as defined in the Rector Employment Agreement), Mr. Rector will receive, over a period of 6 months following termination, compensation at an annual rate equal to his then-existing annual base salary and immediate vesting of any Novation restricted shares that are scheduled to vest within one year after the date of termination of employment, if any, pursuant to Novation's 2015 Incentive Stock Plan.

Jeffrey E. Eberwein

Mr. Eberwein was not party to an employment agreement with the Company. Mr. Eberwein received a base salary of \$100,000 per annum and, on December 12, 2017, received a restricted stock award of \$50,000 of shares vesting one year from the grant date, for serving as Executive Chairman. On December 12, 2017, Mr. Eberwein received one-time additional compensation of \$25,000 in cash and 357,143 shares of restricted stock in recognition of his considerable time and effort in connection with the Company's successful emergence from bankruptcy. Mr. Eberwein resigned from his position as Executive Chairman effective March 27, 2018 and from the Board effective March 31, 2018.

Rodney E. Schwatken

Mr. Schwatken resigned from his positions as the Company's Chief Executive Officer and Chief Financial Officer effective October 1, 2017. In connection with his resignation, to assist with our transition to a new Chief Executive Officer, Mr. Schwatken entered into an agreement (the "Schwatken Transition Agreement") with the Company providing for his continued employment as an Executive Advisor on an "at-will" basis from October 2, 2017 to December 31, 2017 (subject to an extension of up to three months at the Company's discretion) in exchange for (i) a base salary of \$18,750 per month from October 2, 2017 through December 1, 2017 and \$12,500 per month thereafter, (ii) an award of 400,000 restricted shares of the Company's common stock pursuant to the terms and conditions of the 2015 Incentive Plan and an award agreement, such shares vesting in full on January 1, 2018, and (iii) certain other benefits. The Schwatken Transition Agreement also provides for the termination of all of Mr. Schwatken's outstanding options (vested and unvested) to purchase shares of the Company common stock. Mr. Schwatken continues to be bound by certain non-competition, non-solicitation, confidentiality and similar obligations under, and as more particularly described in, his employment agreement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table sets forth certain information with respect to beneficial ownership of the Company's common stock as of April 9, 2018 by: (i) each person, or group of affiliated persons, known to us to beneficially own more than 5% of our outstanding common stock, (ii) each of our directors and named executive officers, and (iii) all of our current directors and executive officers as a group. The amounts and percentages of common stock beneficially owned are reported on the basis of regulations of the SEC governing the determination of beneficial ownership of securities. The information relating to 5% beneficial owners is based on information we received from such holders. Except as otherwise set forth below, the address of the persons listed below is c/o Novation Companies, Inc., 500 Grand Boulevard, Suite 201B, Kansas City, Missouri 64106.

Name of Beneficial Owner	Beneficial Ownership of Common Stock	
	Shares	Percent of Class ⁽¹⁾
Directors and Named Executive Officers		
Howard M. Amster ⁽²⁾	4,267,331	4.4%
Charles M. Gillman ⁽³⁾	304,487	*
Barry A. Igdaloff ⁽⁴⁾	8,473,709	8.7%
Robert G. Pearse ⁽⁵⁾	419,872	*
David W. Pointer	—	—%
Carolyn K. Campbell ⁽⁶⁾	150,000	*
Richard M. Rector ⁽⁷⁾	1,000,000	1.0%
Rodney E. Schwatken ⁽⁸⁾	461,543	*
Jeffrey E. Eberwein ⁽⁹⁾	1,282,368	1.3%
All current directors and executive officers as a group (7 persons) ⁽¹⁰⁾	14,615,399	15.0%

5% Beneficial Owners

Massachusetts Mutual Life Insurance Company ⁽¹¹⁾	19,258,775	19.8%
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* Less than 1%

- (1) Based on 97,138,750 shares of common stock outstanding as of April 9, 2018. Shares of common stock issuable upon exercise of options, warrants or other rights or the conversion of other convertible securities beneficially owned that are exercisable or convertible within 60 days are deemed outstanding for the purpose of computing the percentage ownership of the person holding such securities and rights and all directors and executive officers as a group.
- (2) Consists of 3,248,558 shares of common stock, 208,333 shares of unvested restricted stock and 36,168 shares of common stock issuable upon exercise of options held directly; and 774,272 shares of common stock held in two trusts of which Mr. Amster is the trustee.
- (3) Consists of 96,154 shares of common stock and 208,333 shares of unvested restricted stock.
- (4) Consists of 4,702,497 shares of common stock, 565,476 shares of unvested restricted stock and 36,168 shares of common stock issuable upon exercise of options held directly; and 3,169,568 shares of common stock controlled by Mr. Igdaloff as a registered investment advisor.
- (5) Consists of 211,539 shares of common stock and 208,333 shares of unvested restricted stock.
- (6) Consists of 150,000 shares of unvested restricted stock.
- (7) Consists of 1,000,000 shares of unvested restricted stock.
- (8) Consists of 401,276 shares of common stock held directly and 60,267 shares of stock owned by the Rodney E. Schwatken Trust.
- (9) Consists of 1,274,339 shares of common stock held directly and 8,029 shares of common stock held by Lone Star Value Investors GP, LLC. Mr. Eberwein, as the manager of Lone Star Value Investors GP, LLC, may be deemed the beneficial owner of the securities owned by Lone Star Value Investors GP, LLC. Mr. Eberwein expressly disclaims beneficial ownership of such shares except to the extent of his pecuniary interest therein.
- (10) Consists of 12,202,588 shares of common stock; 2,340,475 shares of unvested restricted stock; and 72,336 shares of common stock issuable upon exercise of options. Excludes shares beneficially owned by Mr. Eberwein and Mr. Schwatken, who are no longer executive officers or directors of the Company.
- (11) Based on a Form 3 filed on December 14, 2011, Massachusetts Mutual Life Insurance Company ("MassMutual") may be deemed to own beneficially and indirectly 19,258,775 shares of common stock held in one or more advisory accounts and private investment funds. Babson Capital Management LLC acts as investment adviser to these advisory accounts and private investment funds, and in such capacities may also be deemed to be the beneficial owner of such shares. The address of MassMutual is 1295 State Street, Springfield, MA 01111.

Equity Compensation Plan Information

The following table sets forth information as of December 31, 2017 with respect to compensation plans under which the Company's common stock may be issued.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Shares Reflected in the First Column)
Equity compensation plans approved by stockholders ⁽¹⁾	72,336	\$1.17	6,152,088
Equity compensation plans not approved by stockholder	—	—	—
Total	<u>72,336</u>	<u>\$1.17</u>	<u>6,152,088</u>

(1) Represents shares that may be issued pursuant to outstanding options awarded under the 2015 Incentive Plan.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Related Party Transactions

The Company has adopted a written policy that addresses the review, approval or ratification of any transaction, arrangement, or relationship or series of similar transactions, arrangements or relationships, including any indebtedness or guarantee of indebtedness, between the Company and any related party, in which the aggregate amount involved exceeds the lesser of \$120,000 or 1% of the average of the Company's total assets at year-end for the last two completed fiscal years. Under the policy, a related party of the Company includes:

- Any executive officer, or any director or nominee for election as a director;
- Any person who owns more than 5% of the Company's voting securities;
- Any immediate family member of any of the foregoing; or
- Any entity in which any of the foregoing persons is employed or is a partner or principal or in a similar position or in which such person has a 10% beneficial ownership interest.

Under the policy, the Board reviews the material facts of any related party transaction and approves it prior to its occurrence. If advance approval is not feasible, then the Board will either ratify the transaction at its next regularly scheduled meeting or the transaction will be rescinded. In making its determination to approve or ratify any related party transaction, the Board may consider such factors as (i) the extent of the related party's interest in the transaction, (ii) if applicable, the availability of other sources of comparable products or services, (iii) whether the terms of the transaction are no less favorable than terms generally available to Company in unaffiliated transactions under like circumstances, (iv) the benefit to the Company, and (v) the aggregate value of the transaction.

No director may engage in any Board discussion or approval of any related party transaction in which he or she is a related party, but that director is required to provide the Board with all material information reasonably requested concerning the transaction.

Director Independence

The Board has determined that all of our directors are independent within the meaning of SEC and NASDAQ rules. The Board has also determined that all directors serving on the Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee are independent within the meaning of SEC and NASDAQ rules. Although the Company's securities are not listed on NASDAQ, the Company uses the independence standards provided in NASDAQ rules in determining whether or not our directors are independent.

Item 14. Principal Accountant Fees and Services

Audit Fees

The following table presents aggregate fees billed for professional services rendered by Boulay PLLP. There were no other professional services rendered or fees billed by Boulay PLLP.

	For the Fiscal Year Ended December 31,	
	2017	2016
Audit fees ⁽¹⁾	\$ 144,977	\$ 74,381
Audit-related ⁽²⁾	—	75,632
Tax	35,883	
Other ⁽³⁾	20,311	—
Total	\$ 201,171	\$ 150,013

- (1) Annual audit and quarterly reviews of our consolidated financial statements, assistance with and review of documents filed with the SEC and an audit of the opening balance sheet of HCS.
- (2) Payments for due diligence for the HCS Acquisition and the Company's bankruptcy filings.
- (3) Payments for the audit of the Company's 401(k) plan.

Pre-Approval Policies and Procedures

The Audit Committee has adopted a policy with respect to the pre-approval of all audit and non-audit services provided by our independent registered public accounting firm. All fees paid to our independent registered public accounting firm for fiscal years 2017 and 2016 were pre-approved in accordance with these policies. Generally, the policy requires that the Audit Committee annually approve fees exceeding \$50,000 for audit services, audit-related and tax services. Fees expected to exceed \$10,000 for all other services must be approved prior to engagement for those services.

PART IV

Item 15. Exhibits and Financial Statements Schedules

Financial Statements and Schedules

- (1) The financial statements as set forth under Item 8 of this Form 10-K are included herein.
- (2) The required financial statement schedules are omitted because the information is disclosed elsewhere herein.

Exhibits

We describe the exhibits filed as part of, or incorporated by reference into, this Form 10-K in the attached Exhibit Index.

EXHIBIT INDEX

Exhibit No.	Description of Document
2.1	Membership Interest Purchase Agreement, dated as of December 21, 2015, by and among Novation Companies, Inc., Corvisa Services LLC and ShoreTel, Inc. (incorporated by reference to Exhibit 2.1 to the Current Report on Form 8-K filed on December 21, 2015).
2.2	Stock Purchase Agreement, dated as of February 1, 2017, by and among Novation Companies, Inc., Novation Holding, Inc., Healthcare Staffing, Inc. and Butler America, LLC (incorporated by reference to Exhibit 2.1 on the Current Report on Form 8-K filed on February 3, 2017).**
2.3	Closing Agreement, dated as of July 27, 2017, by and among Novation Companies, Inc., Novation Holding, Inc., Healthcare Staffing, Inc. and Butler America, LLC (incorporated by reference to Exhibit 2.1 on the Quarterly Report on Form 10-Q filed on February 26, 2018).
3.1	Articles of Amendment and Restatement (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed on August 2, 2017).
3.2	Second Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K filed on August 2, 2017).
4.1	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Quarterly Report Form 10-Q filed on August 5, 2005).
4.2	Rights Agreement, dated as of September 15, 2011, by and between NovaStar Financial, Inc. and Computershare Trust Company, N.A., as rights agent (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K filed on September 21, 2011).
4.3	First Amendment to Rights Agreement, dated June 20, 2014, by and between the Company and Computershare Trust Company, N.A. (incorporated by reference to Exhibit 4.2 to Form 8-A/A filed on June 20, 2014).
4.4	Second Amendment to Rights Agreement, dated August 24, 2015, by and between the Company and Computershare Trust Company, N.A. (incorporated by reference to Exhibit 4.3 to the Form 8-A12G filed on August 28, 2015).
10.1	Form of Indemnification Agreement for Officers and Directors of NovaStar Financial, Inc. and its Subsidiaries (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on November 16, 2005).*
10.2	Novation Companies, Inc. 2015 Incentive Stock Plan (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed on August 7, 2015).*
10.3	Form of Restricted Stock Award Agreement for Non-Employee Directors under the Novation Companies, Inc. 2015 Incentive Stock Plan (incorporated by reference to Exhibit 10.3 to the Annual Report on Form 10-K filed on October 26, 2017).*
10.4	Form of Restricted Stock Award Agreement for Employees under the Novation Companies, Inc. 2015 Incentive Stock Plan (incorporated by reference to Exhibit 10.4 to the Annual Report on Form 10-K filed on October 26, 2017).*
10.5	Amended and Restated 2004 Incentive Stock Plan (as amended May 29, 2014) (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on May 30, 2014).*
10.6	First Amendment to the Company's Amended and Restated 2004 Incentive Stock Plan (incorporated by reference to Appendix A to Form DEF 14A filed on April 25, 2014).*
10.7	Form of Stock Option Agreement under NovaStar Financial, Inc. 2004 Incentive Stock Plan (incorporated by reference to Exhibit 10.25.1 to the Current Report on Form 8-K filed on February 4, 2005).*
10.8	Form of Restricted Stock Award Agreement under NovaStar Financial, Inc. 2004 Incentive Stock Plan (incorporated by reference to Exhibit 10.25.2 to the Current Report on Form 8-K filed on February 4, 2005).*
10.9	Form of Employee Non-Qualified Stock Option Agreement under the Company's Amended and Restated 2004 Incentive Stock Plan (incorporated by reference to Exhibit 10.4 to the Annual Report on Form 10-Q filed on August 7, 2014).*
10.10	Employment Agreement, dated as of January 7, 2008, by and between NovaStar Financial, Inc. and Rodney E. Schwatken (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K/A filed on January 10, 2008).*

- 10.11 [Employment Agreement, dated as of August 9, 2017, by and between Novation Companies, Inc. and Carolyn Campbell.*](#)
- 10.12 [Employment Agreement, dated as of July 27, 2017, by and among Healthcare Staffing, Inc., Novation Companies, Inc. and Richard Rector.*](#)
- 10.13 [Employment Agreement, dated as of March 27, 2018, by and between Novation Companies, Inc. and David Pointer \(incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on March 28, 2018\).*](#)
- 10.14 [Agreement, by and among Novation Companies, Inc. a Maryland corporation, Lone Star Value Investors, LP, Lone Star Value Investors GP, LLC, Lone Star Value Management, LLC and Jeffrey E. Eberwein, dated April 22, 2015 \(incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on April 27, 2015\).](#)
- 10.15 [Senior Secured Note Purchase Agreement, dated as of July 27, 2017, among Novation Companies, Inc., Novation Holding, Inc., Healthcare Staffing, Inc., Taberna Preferred Funding I, Ltd., Taberna Preferred Funding II, Ltd., Kodiak CDO I, Ltd., and Wilmington Savings Fund Society, FSB \(incorporated by reference to Exhibit 10.1 on the Quarterly Report on Form 10-Q filed on February 26, 2018\).](#)
- 10.16 [Revolving Credit and Security Agreement, dated as of November 17, 2017, by and between HCS and Federal National Payables, Inc. \(incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on November 20, 2017\).](#)
- 21.1 [Subsidiaries of the Registrant.](#)
- 23.1 [Consent of Boulay PLLP.](#)
- 31.1 [Principal Executive Officer Certification filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](#)
- 31.2 [Principal Financial Officer Certification filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](#)
- 32.1 [Principal Executive Officer Certification furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 32.2 [Principal Financial Officer Certification furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 101 The following financial information from Novation Companies, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2017, formatted in XBRL (Extensible Business Reporting Language) includes: (i) Consolidated Balance Sheets as of December 31, 2017 and December 31, 2016, (ii) Consolidated Statements of Operations for the years ended December 31, 2017 and 2016, (iii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2017 and 2016, (iv) Consolidated Statements of Shareholders' Deficit for the years ended December 31, 2017 and 2016, (v) Consolidated Statements of Cash Flows for the years ended December 31, 2017 and 2016, and (vi) the Notes to Consolidated Financial Statements.

* Management contract or compensatory plan or arrangement.

** The registrant has omitted certain schedules and exhibits to this agreement in accordance with Item 601(b)(2) of Regulation S-K, and will supplementally furnish a copy of any omitted schedule and/or exhibit to the Securities and Exchange Commission upon request.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NOVATION COMPANIES, INC.

DATE: April 10, 2018

/s/ DAVID W. POINTER

David W. Pointer, Chief Executive Officer and Chairman

DATE: April 10, 2018

/s/ CAROLYN K. CAMPBELL

Carolyn K. Campbell, Chief Financial Officer

Power of Attorney

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints David Pointer and Carolyn Campbell, jointly and severally, his or her attorneys-in-fact, each with the power of substitution, for him or her in any and all capacities, to sign any amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and dates indicated.

DATE: April 10, 2018

/s/ DAVID W. POINTER

David W. Pointer, Chief Executive Officer and Chairman
(Principal Executive Officer)

DATE: April 10, 2018

/s/ CAROLYN K. CAMPBELL

Carolyn K. Campbell, Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

DATE: April 10, 2018

/s/ HOWARD M. AMSTER

Howard M. Amster, Director

DATE: April 10, 2018

/s/ CHARLES M. GILLMAN

Charles M. Gillman, Director

DATE: April 10, 2018

/s/ BARRY A. IGDALOFF

Barry A. Igdaloff, Director

DATE: April 10, 2018

/s/ ROBERT G. PEARSE

Robert G. Pearse, Director

August 9, 2017

Carolyn Campbell
8805 Custer Trail
Kansas City, MO 64131

Dear Carolyn:

On behalf of Novation Companies, Inc. (the "Company"), we are pleased to present this offer for you to join the Company in the position of Chief Financial Officer of the Company, and to serve as the Company's Principal Financial Officer and Principal Accounting Officer, reporting to the Executive Chairman of the Board of Directors. We anticipate that your start date will be no later than August 14, 2017. This letter sets forth the terms of our offer regarding your compensation and other benefits.

1. **Compensation.**

- a. **Base Salary:** Your base salary shall be \$125,000 per annum, payable in accordance with the Company's standard payroll practices, less applicable withholdings and deductions.
- b. **Bonus:** You may be eligible to receive an annual bonus, which bonus shall be awarded at the discretion of the Company.
- c. **Equity:** At the discretion of the Company, you may be eligible to participate in any equity programs of the Company, in accordance with the provisions of the programs as the same may be in effect from time to time.

2. **Benefits.**

- a. **Health Insurance:** You shall be eligible to participate in the Company's health insurance program and other Company employee benefit programs, if any, that are provided by the Company for its employees at your level in accordance with the provisions of any such plans, as the same may be in effect from time to time.
- b. **Vacation:** You shall be entitled to vacation in accordance with the Company's standard vacation policy extended to executives of the Company generally, at levels commensurate with your position.

3. **"At-Will" Employment.** You acknowledge that you are an employee-at-will and may be terminated by the Company at any time for any legally permissible reason.

4. **Payments Upon Termination Without Cause.**

- a. **Severance:** If your employment is terminated by the Company at any time for reasons other than Cause (as defined below), your death or disability, you shall be entitled to receive (i) your base salary accrued up to and including the date of termination; (ii) payment in lieu of any accrued but unused vacation time, in accordance with the Company's vacation policy; (iii) upon submission of required documentation, payment of any unreimbursed expenses in accordance with the Company's business reimbursement policy; (iv) up to and including the date of termination, any payments and benefits under any Company benefit plan, program or policy that you participated in during employment and paid pursuant to the terms of such plan, program or policy; and (v) a severance payment equal to three (3) months of your annual base salary, to be paid in installments in accordance with the Company's standard payroll procedures, less applicable withholdings and deductions, provided that all such payments and benefits are subject to your execution and delivery of a general release (that is no longer subject to revocation under applicable law) of the Company, its parents, subsidiaries and affiliates and each of its officers, directors, employees, agents, successors and assigns in a form that the Company shall present to you. All payments under this section 4.a. shall begin to be made within sixty (60) days following termination of employment; provided, however, that if the sixty (60) day period begins in one calendar year and ends in the second calendar year, all payments

will be made in the second calendar year. For the avoidance of doubt, no severance payment will be made upon your termination for Cause, upon death, disability or upon voluntary termination by you for any reason.

b. **Cause:** For purposes of this letter, "Cause" for termination shall mean that you: (A) plead "guilty" or "no contest" to or you are indicted for or convicted of a felony under federal or state law or as a crime under federal or state law which involves your fraud or dishonesty; (B) in carrying out your duties, you engage in conduct that constitutes gross negligence or willful misconduct; (C) fail to reasonably perform the responsibilities of your position; (D) engage in misconduct that causes material harm to the reputation of the Company; or (E) materially breach any term of this letter or written policy of the Company; provided that for subsections (C) and (E), if the breach reasonably may be cured, you have been given at least thirty (30) days after the receipt of written notice of such breach from the Company to cure such breach.

5. **Confidentiality.** As a condition of your employment, you will be required to sign and comply with any Company confidentiality agreements or other similar agreements provided to you by the Company.

By accepting the Company's offer of employment, you represent that your acceptance of the offer does not, and will not cause you to violate any current contract or commitment, and it is a condition of your employment that there are no constraints on your ability to fully perform the duties of the position offered. This offer letter comprises the entire description of your compensation, and fully supersedes any and all prior discussions, documents, promises, agreements, letters, and memoranda regarding this subject matter.

We look forward to working with you. Please call me with any questions or comments you may have.

Very truly yours,

Novation Companies, Inc.

/s/ Rodney E. Schwatken
Rodney E. Schwatken
Chief Executive Officer

AGREED AND ACCEPTED:

By: /s/ Carolyn Campbell
Carolyn Campbell

EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT (the “Agreement”), dated as of July 27, 2017, is by and among HEALTHCARE STAFFING, INC. (the “Company”), NOVATION COMPANIES, INC. (“Parent”), and RICHARD RECTOR (“Executive”).

W I T N E S S E T H:

WHEREAS, the Company’s entry into an employment agreement with Executive is a condition to closing the transactions contemplated by the Stock Purchase Agreement, dated as of February 1, 2017 (the “Purchase Agreement”), by and among Parent, Novation Holding, Inc. (“Buyer”), Butler America, LLC (“Seller”), and the Company, including Buyer’s acquisition of all of the outstanding shares of capital stock of the Company from Seller (the “Acquisition”);

WHEREAS, Executive currently serves as the President of the Company; and

WHEREAS, the Company desires to employ Executive as President of the Company following the Closing (as defined in the Purchase Agreement), and the parties hereto desire to enter into this Agreement embodying the terms of such employment to become effective on the Closing Date.

NOW, THEREFORE, in consideration of the premises and the mutual covenants and promises of the parties contained herein, the parties hereto, intending to be legally bound, hereby agree as follows:

1. Title and Job Duties.

(a) Subject to the terms and conditions set forth in this Agreement, the Company agrees to employ Executive as President of the Company. In this capacity, Executive shall have the same duties, authorities and responsibilities that Executive had immediately prior to the Closing, which are commensurate with those of persons in similar capacities in similarly sized companies, including awarding bonuses to employees of the Company at Executive’s discretion under the Company’s management bonus plans and such other duties, authorities and responsibilities as the Board of Directors of the Company (the “Board”) shall designate from time to time that are not inconsistent with Executive’s position as President of the Company.

(b) Executive accepts such employment and agrees, during the term of his employment, to devote his full business and professional time and energy to the Company. Executive agrees to carry out and abide by all lawful directions of the Board that are consistent with his position as President of the Company.

(c) Without limiting the generality of the foregoing, Executive shall not, without the written approval of the Board, render services of a business or commercial nature on his own behalf or on behalf of any other person, firm, or corporation, whether for compensation or otherwise, during his employment hereunder; provided that the foregoing shall not prevent Executive from (i) serving on the boards of directors of, or holding any other offices or positions in non-profit organizations and, with the prior written approval of the Company, other for-profit companies, (ii) participating in charitable, civic, educational, professional, community or activities in the aggregate do not materially interfere or conflict with Executive’s duties hereunder or create a potential business or fiduciary conflict.

2. Salary and Additional Compensation.

(a) Base Salary. During the Term, the Company shall pay to Executive an annual base salary of \$225,000 (the “Base Salary”), less applicable withholdings and deductions, in accordance with the Company’s normal payroll procedures.

(b) Quarterly Bonus. Executive shall be eligible to earn a bonus each calendar quarter (the “Quarterly Bonus”) as set forth below. The Quarterly Bonus, if any, shall be paid, less applicable withholdings and deductions, within the thirty (30) day period following the end of the calendar quarter in which such Quarterly Bonus was earned.

Provided the Company achieves a budgeted earnings before interest, taxes, and amortization (“EBITA”) at an amount to be determined by the Company and approved by the Board each calendar quarter, Executive shall earn a bonus as follows:

Projected Budget Achieved	Bonus
Below 95%	None
95% to 100%	3.5% of EBITA
100.01% to 105%	4% of EBITA
105.01% to 110%	6% of EBITA
110.01% to 115%	7.5% of EBITA
115.01% and above	10% of EBITA

(c) Options. Executive shall be eligible to participate in Parent’s 2015 Incentive Stock Plan (the “2015 Plan”) and such other similar equity incentive plans established by Parent, subject to grants of awards at the discretion of the Compensation Committee of Parent’s Board of Directors (the “Compensation Committee”) and in accordance with the provisions of such plan as the same may be in effect from time to time.

(d) Restricted Stock. On the Closing Date and upon approval of the Compensation Committee, Executive shall be granted one million (1,000,000) restricted shares of Parent’s common stock (the “Restricted Shares”), to be issued to Executive pursuant to the terms and conditions of this Agreement and the 2015 Plan. The Restricted Shares shall vest as follows: forty percent (40%) on the first anniversary of the Closing Date; thirty-five percent (35%) on the second anniversary of the Closing Date; and twenty-five percent (25%) on the third anniversary of the Closing Date.

3. Benefits.

(a) Vacation. Executive shall be entitled to vacation in accordance with the Company’s standard vacation policy extended to employees of the Company generally, at levels commensurate with Executive’s position.

(b) Health Insurance and Other Plans. Executive shall be eligible to participate in the Company’s medical and other employee benefit programs, if any, that are provided by the Company for its employees generally, at levels commensurate with Executive’s position, in accordance with the provisions of any such plans, as the same may be in effect from time to time.

(c) Key Man Insurance. The Company shall have the right to obtain and maintain insurance policies against the Death or Disability (each as defined below) of Executive, in such amounts as the Company, or the affiliate seeking such coverage, deems appropriate, and to name itself as beneficiary

under any such policy. Executive shall promptly submit to such medical examinations and provide information as the insurers for such policies may reasonably require.

(d) Automobile Allowance. The Company agrees to provide Executive with the private use of a Company owned or leased automobile during the Term in accordance with the Company's car allowance policy, if any. In the alternative, the Company agrees to pay to Executive, during the Term, a reasonable amount per month as an automobile allowance to be used to purchase, lease, own, operate and/or maintain a vehicle in accordance with the Company's car allowance policy, if any.

4. Expenses. In accordance with Company policy, the Company shall reimburse Executive for all reasonable business expenses properly and reasonably incurred and paid by Executive in the performance of his duties under this Agreement upon his presentment of reasonably detailed receipts in the form required by the Company's policy. The Company shall reimburse Executive for the costs associated with business related flights for which Executive utilizes his flying club, upon presentment of reasonably detailed receipts in the form required by the Company's policy.

5. Term of Employment. The terms set forth in this Agreement will commence on the Closing Date and shall remain in effect until termination pursuant to Section 6 below, provided that the terms set forth in Sections 8, 9 and 10 below shall survive.

6. Termination.

(a) Termination at the Company's Election.

(i) For Cause. At the election of the Company, Executive's employment may be terminated for Cause (as defined below) immediately upon written notice to Executive. For purposes of this Agreement, "Cause" for termination shall mean that Executive: (A) pleads "guilty" or "no contest" to or is indicted for or convicted of a felony under federal or state law or a crime under federal or state law which involves Executive's fraud or dishonesty; (B) in carrying out his duties, engages in conduct that constitutes gross negligence or willful misconduct; (C) fails to reasonably perform the responsibilities of his position; (D) engages in misconduct that causes material harm to the reputation of the Company; or (E) materially breaches any term of this Agreement or written policy of the Company, provided that for subsections (C) through (E), if the breach reasonably may be cured, Executive has been given at least thirty (30) days after Executive's receipt of written notice of such breach from the Company to cure such breach. Whether or not such breach has been cured will be determined in the judgment of the Board.

(ii) Upon Disability, Death or Without Cause. At the election of the Company, Executive's employment may be terminated without Cause: (A) should Executive, by reason of any medically determinable physical or mental impairment, become unable to perform, with or without reasonable accommodation, the essential functions of his job for the Company hereunder and such incapacity has continued for a total of ninety (90) consecutive days or for any one hundred eighty (180) days in a period of three hundred sixty-five (365) consecutive days (a "Disability"); (B) upon Executive's death ("Death"); or (C) upon thirty (30) days' written notice to Executive for any other reason or for no reason at all ("Without Cause").

(b) Termination at Executive's Election.

(i) For Good Reason. At Executive's election, Executive's employment may be terminated for Good Reason (as defined below) by providing written notice to the Company pursuant to Section 12 of this Agreement. For purposes of this Agreement, "Good Reason" shall be deemed to exist

if the following actions occur without Executive's consent: (A) a material diminution in Executive's Base Salary; or (B) a material diminution in Executive's title, authority, duties or responsibilities under this Agreement. In the event any of the occurrences in (A) and (B) above have occurred, Executive will give the Company written notice of Executive's intention to so terminate Executive's employment for Good Reason, with such notice: (i) to state in reasonable detail the particular acts or failures to act that constitute the grounds on which the proposed termination for Good Reason is based; and (ii) to be given within thirty (30) days after the first occurrence of such acts or failures to act. The Company shall have thirty (30) days following receipt of such notice to cure such acts or failures to act. If the Company has not cured such acts or failures to act within the thirty (30) day cure period, then Executive's employment shall terminate for Good Reason.

(ii) Voluntary Resignation. Notwithstanding anything contained elsewhere in this Agreement to the contrary, Executive may terminate his employment hereunder at any time and for any reason whatsoever or for no reason at all in Executive's sole discretion by giving thirty (30) days' written notice to the Company pursuant to Section 12 of this Agreement ("Voluntary Resignation").

7. Payments Upon Termination of Employment.

(a) Termination for Cause, Death, Disability or Voluntary Resignation. If Executive's employment is terminated by the Company for Cause, Death or Disability or is terminated by Executive as a Voluntary Resignation, then the Company shall pay or provide to Executive the following amounts only: (i) his Base Salary accrued up to and including the date of termination or resignation, paid within thirty (30) days or at such earlier time required by applicable law; (ii) accrued, unused vacation time, paid in accordance with the Company's written policies and applicable law; (iii) unreimbursed expenses, paid in accordance with this Agreement and the Company's written policies; and (iv) accrued benefits under any Company benefit plan, paid pursuant to the terms of such benefit plan (collectively, the "Accrued Obligations").

terminates Executive's employment Without Cause or if Executive terminates his employment with Good Reason, the Company shall pay to Executive the Accrued Obligations and severance payments and/or benefits as follows: (i) Executive's Base Salary for a period of six (6) months, to be paid in installments in accordance with the Company's standard payroll practices; and (ii) immediate vesting of any Restricted Shares that are scheduled to vest within one year after the date of termination of employment, if any, pursuant to the 2015 Plan. Such payments and/or benefits are subject to Executive's execution and delivery of a general release (that is no longer subject to revocation under applicable law) of the Company, its parents, subsidiaries and affiliates and each of their respective officers, directors, employees, agents, successors and assigns in the form attached hereto as Exhibit A (the "General Release"). All payments under clause (i) above shall begin to be made within sixty (60) days following termination of employment; provided, however, that to the extent required by Code Section 409A (as defined below), if the sixty (60) day period begins in one calendar year and ends in the second calendar year, all payments will be made in the second calendar year. The payments under this Section 7(b) shall immediately cease should Executive violate any of the obligations set forth in Sections 8, 9 and 10 below.

8. Confidentiality.

(a) Executive understands that during the Term, he may have access to unpublished and otherwise confidential information both of a technical and non-technical nature, relating to the business of the Company or any of its parents, subsidiaries, divisions, affiliates (collectively, "Affiliated Entities"), or clients, including without limitation any of their actual or anticipated business, research or development,

any of their technology or the implementation or exploitation thereof, including without limitation information Executive and others have collected, obtained or created, information pertaining to clients, accounts, vendors, prices, costs, materials, processes, codes, material results, technology, system designs, system specifications, materials of construction, trade secrets or equipment designs, including information disclosed to the Company or any of its Affiliated Entities by others under agreements to hold such information confidential (collectively, the "Confidential Information"). Executive agrees to observe all policies and procedures of the Company and its Affiliated Entities concerning such Confidential Information. Executive further agrees not to disclose or use, either during his employment or at any time thereafter, any Confidential Information for any purpose, including without limitation any competitive purpose, unless authorized to do so by the Company in writing, except that he may disclose and use such information in the good faith performance of his duties for the Company. Executive's obligations under this Agreement will continue with respect to Confidential Information, whether or not his employment is terminated, until such information becomes generally available from public sources through no fault of Executive or any representative of Executive. Notwithstanding the foregoing, however, Executive shall be permitted to disclose Confidential Information as may be required by a subpoena or other governmental order, provided that he first notifies the Company of such subpoena, order or other requirement and such that the Company has the opportunity to obtain a protective order or other appropriate remedy.

(b) During Executive's employment, upon the Company's request, or upon the termination of his employment for any reason, Executive will promptly deliver to the supplier lists, cost and profit data, e-mail, apparatus, laptops, computers, smartphones, tablets or other PDAs, hardware, software, drawings, blueprints, and any other material of the Company or any of its Affiliated Entities or clients, including all materials pertaining to Confidential Information developed by Executive or others, and all copies of such materials, whether of a technical, business or fiscal nature, whether on the hard drive of a laptop or desktop computer, in hard copy, disk or any other format, which are in his possession, custody or control.

9. Assignment of Intellectual Property.

(a) Executive will promptly disclose to the Company any idea, invention, discovery or improvement, whether patentable or not ("Creations"), conceived or made by him alone or with others at any time during his employment with the Company. Executive agrees that the Company owns any such Creations, and Executive hereby assigns and agrees to assign to the Company all moral and other rights he has or may acquire therein and agrees to execute any and all applications, assignments and other instruments relating thereto which the Company deems necessary or desirable. These obligations shall continue beyond the termination of his employment with respect to Creations and derivatives of such Creations conceived or made during his employment with the Company. The Company and Executive understand that the obligation to assign Creations to the Company shall not apply to any Creation which is developed entirely on his own time without using any of the Company's equipment, supplies, facilities, and/or Confidential Information ("Executive Creations") unless such Creation (i) relates in any way to the business or to the current or anticipated research or development of the Company or any of its Affiliated Entities, or (ii) results in any way from his work at the Company.

(b) In any jurisdiction in which moral rights cannot be assigned, Executive hereby waives any such moral rights and any similar or analogous rights under the applicable laws of any country of the world that Executive may have in connection with the Creations, and to the extent such waiver is unenforceable, hereby covenants and agrees not to bring any claim, suit or other legal proceeding against the Company or any of its Affiliated Entities claiming that Executive's moral rights to the Creations have been violated.

(c) Executive agrees to reasonably cooperate with the Company, both during and after his employment with the Company, with respect to the procurement, maintenance and enforcement of copyrights, patents, trademarks and other intellectual property rights (both in the United States and foreign countries) relating to such Creations. Executive shall sign all papers, including, without limitation, copyright applications, patent applications, declarations, oaths, formal assignments, assignments of priority rights and powers of attorney, which the Company, acting reasonably, may deem necessary or desirable in order to protect its rights and interests in any Creations. Executive further agrees that if the Company is unable, after reasonable effort, to secure Executive's signature on any such papers, any officer of the Company shall be entitled to execute such papers as his agent and attorney-in-fact and Executive hereby irrevocably designates and appoints each officer of the Company as his agent and attorney-in-fact to execute any such papers on his behalf and to take any and all actions as the Company may deem necessary or desirable in order to protect its rights and interests in any Creations, under the conditions described in this paragraph, all to the exclusion of Executive's Creations.

10. Non-Competition; Non-Solicitation.

(a) During Executive's employment with the Company or its Affiliated Entities and for twenty-four (24) months following the termination thereof for any reason (the "Restricted Period"), the Executive shall not, within the Territory (as defined below) directly or indirectly, own, manage, operate, control, consult with, be employed by, participate in the ownership, management, operation or control of, or otherwise render services to or engage in, any business engaged in or competitive with the businesses conducted by the Company or any of its Affiliated Entities; provided, that the Executive's ownership of securities of 2% or less of any publicly traded class of securities of a public company shall not violate this paragraph.

(b) Throughout the Restricted Period, the Executive shall not solicit for business or accept the business of, any person or entity who is, or was at any time within the previous twelve (12) months, a Customer (as defined below) of the Company or any of its Affiliated Entities.

(c) Throughout the Restricted Period, the Executive shall not, directly or indirectly, employ, solicit, for employment, or otherwise contract for or hire, the services of any individual who is then an employee of or consultant to the Company or any of its Affiliated Entities or who was an employee of the Company or any of its Affiliated Entities during the twelve (12) month period preceding the termination of his employment.

(d) Throughout the Restricted Period, the Executive shall not take any action that could reasonably be expected to have the effect of encouraging or inducing any employee, consultant, representative, officer, or director of the Company or any of its Affiliated Entities to cease their relationship with the Company or any of its Affiliated Entities for any reason.

(e) For purposes of this Agreement, the term "Territory" shall mean throughout the area comprising the Company's or any of its Affiliated Entities, as applicable, market for its services and products within which area Executive was materially concerned during the twelve (12) month period prior to the termination of Executive's employment.

(f) For purposes of this Agreement, the term "Customer(s)" shall mean any individual, corporation, partnership, business or other entity, whether for-profit or not-for-profit, public, privately held, or owned by the United States government that is a business entity or individual with whom the Company or any of its Affiliated Entities has done business or with whom Executive has actively negotiated with

during the twelve (12) month period preceding the termination of Executive's employment.

(g) Executive and the Company agrees that in the event a court determines the length of time, territory or activities prohibited under this Agreement are too restrictive to be enforceable, the court may reduce the scope of the restriction to the extent necessary to make the restriction enforceable.

11. Representation and Warranty. Executive represents and warrants to the Company that he is not subject to any agreement restricting his ability to enter into this Agreement and fully carry out his duties and responsibilities hereunder. Executive hereby indemnifies and holds the Company harmless against any losses, claims, expenses (including reasonable attorneys' fees), damages or liabilities incurred by the Company as a result of a breach of the foregoing representation and warranty.

12. Notice. Any notice or other communication required or permitted to be given to any of the parties hereto shall be deemed to have been given when personally delivered, or one business day after being sent by nationally recognized overnight courier, and addressed as follows:

If to Executive, to:

the address shown on the records of the Company. If to

the Company, to:

Healthcare Staffing, Inc.
1724 Phoenix Parkway
Building 600
College Park, GA 30349

Attention: Board of Directors with

copies to:

Novation Companies, Inc.
500 Grand Boulevard, Suite 201B
Kansas City, MO 64106
Attention: Rodney E. Schwatken

Olshan Frome Wolosky LLP
1325 Avenue of the Americas
New York, New York 10019
Attention: Adam W. Finerman, Esq.

13. Severability. If any provision of this Agreement is declared void or unenforceable by a court of competent jurisdiction, all other provisions shall nonetheless remain in full force and effect.

14. Governing Law; Jurisdiction. This Agreement shall be governed by, and construed and enforced in accordance with, the laws of the State of Georgia without regard to the conflict of laws provisions thereof. Each of the parties hereto hereby irrevocably submits to the exclusive jurisdiction of any appropriate state court of record in the state of Georgia, over any action or proceeding arising out of or relating to this Agreement and each of the parties hereto hereby irrevocably agrees that all claims in respect of such action or proceeding shall be heard and determined in such Georgia state or Federal court. Each of the parties hereto hereby irrevocably waives, to the fullest extent legally possible, the defense of an inconvenient forum to the maintenance of such action or proceeding.

15. Code Section 409A Compliance.

(a) The intent of the parties is that payments and benefits under this Agreement comply with, or be exempt from, Section 409A the United States Internal Revenue Code of 1986, as amended (the “Code”), and the regulations and guidance promulgated thereunder (collectively, “Code Section 409A”) and, accordingly, to the maximum extent permitted, this Agreement shall be interpreted and administered accordingly.

(b) A termination of employment shall not be deemed to have occurred for purposes of any provision of this Agreement providing for the payment of any amounts or benefits upon or following a termination of employment that are considered “nonqualified deferred compensation” under Code Section 409A unless such termination is also a “separation from service” within the meaning of Code Section 409A and, for purposes of any such provision of this Agreement, references to a “termination,” “termination of employment” or like terms shall mean “separation from service.”

(c) With regard to any provision herein that provides for reimbursement of costs and expenses or in-kind benefits, except as permitted by Code Section 409A, (i) the right to reimbursement or in-kind benefits shall not be subject to liquidation or exchange for another benefit, (ii) the amount of expenses eligible for reimbursement, or in-kind benefits, provided during any taxable year shall not affect the expenses eligible for reimbursement, or in-kind benefits to be provided, in any other taxable year, provided that the foregoing clause (ii) shall not be violated without regard to expenses reimbursed under any arrangement covered by Code Section 105(b) solely because such expenses are subject to a limit related to the period the arrangement is in effect and (iii) such payments shall be made on or before the last day of Executive’s taxable year following the taxable year in which the expense occurred.

(d) For purposes of Code Section 409A, Executive’s right to receive any installment payments pursuant to this Agreement shall be treated as a right to receive a series of separate and distinct payments. Whenever a payment under this Agreement specifies a payment period with reference to a number of days (e.g., “within sixty (60) days following the date of termination”), the actual date of payment within the specified period shall be within the sole discretion of the Company.

(e) If Executive is a specified employee within the meaning of Section 409A(a)(2)(B)(i) of the Code and would receive any payment sooner than six (6) months after Executive’s “separation from service” that, absent the application of this Section 15(e), would be subject to additional tax imposed pursuant to Code Section 409A as a result of such status as a specified employee, then such payment shall instead be payable on the date that is the earliest of (i) six (6) months after Executive’s “separation from service,” or (ii) Executive’s death.

16. Waiver. The waiver by any of the parties hereto of a breach of any provision of this Agreement shall not be construed as a waiver of any subsequent breach. The failure of a party to insist upon strict adherence to any provision of this Agreement on one or more occasions shall not be considered a waiver or deprive that party of the right thereafter to insist upon strict adherence to that provision or any other provision of this Agreement. Any waiver must be in writing.

17. Assignment. This Agreement is a personal contract and Executive may not sell, transfer, assign, pledge or hypothecate his rights, interests and obligations hereunder. Except as otherwise herein expressly provided, this Agreement shall be binding upon and shall inure to the benefit of Executive and

his personal representatives and shall inure to the benefit of and be binding upon the Company and its successors and assigns, except that the Company may not assign this Agreement without Executive's prior written consent, except to an acquirer of all or substantially all of the assets of the Company.

18. Injunctive Relief. Without limiting the remedies available to the Company, Executive acknowledges that a breach of any of the covenants contained in Sections 8, 9 and 10 would result in material irreparable injury to the goodwill of the Company for which there is no adequate remedy at law, that it will not be possible to measure damages for such injuries precisely and that, in the event of such a breach or threat thereof, the Company shall be entitled, without the requirement to post bond or other security, to obtain a temporary restraining order and/or preliminary or permanent injunction restraining Executive from engaging in activities prohibited by this Agreement or such other relief as may be required to specifically enforce any of the covenants in Sections 8, 9 and 10 of this Agreement, in addition to all other remedies available at law or in equity.

19. Counterparts. This Agreement may be executed in multiple counterparts, each of which shall be deemed an original and all of which together shall be considered one and the same agreement and shall become effective when one or more counterparts have been signed by each of the parties and delivered to the other party. Facsimile or .pdf signatures shall have the same force and effect as original signatures.

20. Entire Agreement. This Agreement embodies all of the representations, warranties and agreements between the parties hereto relating to Executive's employment with the Company. No other representations, warranties, covenants, understandings, or agreements exist between the parties hereto relating to Executive's employment. This Agreement shall supersede all prior agreements, written or oral, relating to Executive's employment. This Agreement may not be amended or modified except by a writing signed by each of the parties hereto. Sections 8, 9 and 10 of this Agreement shall survive the termination of this Agreement.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed and delivered on the date above.

HEALTHCARE STAFFING, INC.

/s/ Rodney E. Schwatken

Rodney E. Schwatken
Vice President, Secretary & Treasurer

NOVATION COMPANIES, INC.

/s/ Rodney E. Schwatken

Name: Rodney E. Schwatken
Title: Chief Executive Officer

Agreed to and Accepted:

/s/ Richard M. Rector

Richard Rector

EXHIBIT A
AGREEMENT AND RELEASE

Agreement and Release (“Agreement”) executed this day of , 20, by and between RICHARD RECTOR (“Executive”) with an address at and HEALTHCARE STAFFING, INC. (the “Company”) with an address at _____.

1. Executive’s employment shall be terminated effective (“Termination Date”). As of that date, Executive’s duties, responsibilities, office and title shall cease. Capitalized terms used without definition in this Agreement shall have the meanings set forth in the Employment Agreement by and between Executive and the Company, dated as of , 2017 (the “Employment Agreement”).

2. (a) If Executive’s employment terminates pursuant to Sections 6(a)(ii)(C) or (b)(i) of the Employment Agreement, then within ten days of the Release Effective Date (as defined below), the Company shall begin to pay to Executive the severance payments described in Section 7(b) of the Employment Agreement in accordance with the terms set forth therein, and the Company’s standard payroll procedures.

(b) The Company and Executive agree that in the event that any of the severance payments in this Section 2 constitute deferred compensation within the meaning of Code Section 409(A), such payment or payments that constitute nonqualified deferred compensation within the meaning of the Code shall not be made prior to the date which is the earlier of (A) the expiration of the six (6) month period measured from the date of the “separation from service” of Executive, and (B) thirty (30) days from the date of Executive’s death (within the meaning of the Code).

3. Executive agrees and acknowledges that the payments and/or benefits provided in Section 2 above exceed any payments and benefits to which Executive would otherwise be entitled under any policy, plan, and/or procedure of the Company absent his signing this Agreement. Executive acknowledges that he has been paid for work performed up to and including the Termination Date and for accrued but unused vacation.

4. [IF EXECUTIVE IS OVER 40 AT THE TIME OF TERMINATION] Executive shall have up to twenty-one (21) days from the date of his receipt of this Agreement to consider the terms and conditions of this Agreement. Executive may accept this Agreement at any time within the twenty-one (21) day period by executing it and returning it to the Board at , no later than 5:00 p.m. on the twenty-first (21st) day after Executive’s receipt of this Agreement. Thereafter, Executive will have seven (7) days to revoke this Agreement by stating his desire to do so in writing to the Board at the address listed above, and delivering it to the Board no later than 5:00 p.m. on the seventh (7th) day following the date Executive signs this Agreement. The effective date of this Agreement shall be the eighth (8th) day following Executive’s signing of this Agreement (the “Release Effective Date”), provided Executive does not revoke the Agreement during the revocation period. In the event Executive does not accept this Agreement as set forth above, or in the event Executive revokes this Agreement during the revocation period, this Agreement, including but not limited to the obligation of the Company and its subsidiaries and affiliates to provide the severance payments referred to in Section 2 above, shall automatically be deemed null and void.

5. (a) In consideration of the severance payments referred to in Section 2 above, Executive for himself and for his heirs, executors, and assigns (hereinafter collectively referred to as the “Releasers”), forever releases and discharges the Company and any and all of its parent corporations, subsidiaries, divisions, affiliated entities, predecessors, successors and assigns, and any and all of its and their employee benefit and/or pension plans and funds (except to the extent Executive has remaining rights under such benefit and/

or pension plans and funds, in which case they are not released), and any and all of its and their past or present officers, directors, stockholders, agents, trustees, administrators, employees and assigns (whether acting as agents for such entities or in their individual capacities) (hereinafter collectively referred to as the "Releasees"), from any and all claims, demands, causes of action, fees and liabilities of any kind whatsoever (based upon any legal or equitable theory, whether contractual, common-law, statutory, decisional, federal, state, local or otherwise), whether known or unknown, which Releasers ever had, now have or may have against the Releasees or any of them by reason of any actual or alleged act, omission, transaction, practice, conduct, occurrence, or other matter from the beginning of the world up to and including the Release Effective Date, except for the obligations of the Company under this Agreement.

(b) Without limiting the generality of the foregoing subsection (a), this Agreement is intended to and shall release the Releasees from any and all claims arising out of Executive's employment with Releasees and/or the termination of Executive's employment, including but not limited to any claim(s) under or arising out of (i) Title VII of the Civil Rights Act of 1964, as amended, (ii) the Americans with Disabilities Act, as amended, (iii) the Employee Retirement Income Security Act of 1974, as amended ("ERISA") (excluding claims for accrued, vested benefits under any employee benefit plan of the Company in accordance with the terms of such plan and applicable law), (iv) the Age Discrimination in Employment Act, as amended, or the Older Workers Benefit Protection Act, (v) the Georgia Fair Employment Practices Act, (vi) alleged discrimination or retaliation in employment (whether based on federal, state or local law, statutory or decisional), (vii) the terms and conditions of Executive's employment with the Company, the termination of such employment, and/or any of the events relating directly or indirectly to or surrounding that termination, and (viii) any law (statutory or decisional) providing for attorneys' fees, costs, disbursements and/or the like.

(c) Notwithstanding the foregoing, nothing in this Agreement shall be construed to prevent Executive from filing a charge with or participating in an investigation conducted by any governmental agency, including, without limitation, the United States Equal Employment Opportunity Commission ("EEOC") or applicable state or city fair employment practices agency, to the extent required or permitted by law. Nevertheless, Executive understands and agrees that he is waiving any relief available (including, for example, monetary damages or reinstatement), under any of the claims and/or causes of action waived in Sections 5(a) and (b), including but not limited to financial benefit or monetary recovery from any lawsuit filed or settlement reached by the EEOC or anyone else with respect to any claims released and waived in this Agreement.

6. (a) Executive agrees that he has not and will not engage in any conduct that is injurious to the Company's or any of the Releasees' reputation or interest, including but not limited to publicly disparaging (or inducing or encouraging others to publicly disparage) the Company or the Releasees.

(b) Executive acknowledges that he has returned to the Company any and all originals and copies of documents, materials, records, credit cards, keys, building passes, computers, blackberries and other electronic devices and other items in his possession or control belonging to the Company or containing proprietary information relating to the Company.

(c) Executive acknowledges that the terms of Section 8 (Confidentiality), Section 9 (Assignment of Intellectual Property), and Section 10 (Non-Competition; Non-Solicitation) of the Employment Agreement are incorporated herein by reference, and Executive agrees and acknowledges that he is bound by their terms.

7. (a) Executive will cooperate with the Company and/or its subsidiaries and affiliates and its/their counsel in connection with any investigation, administrative proceeding or litigation relating to any

matter in which Executive was involved or of which Executive has knowledge during the period for which the severance payment is being made.

(b) Executive agrees that, in the event he is subpoenaed by any person or entity (including, but not limited to, any government agency) to give testimony (in a deposition, court proceeding or otherwise) that in any way relates to Executive's employment with the Company, he will give prompt notice of such request to the Board, and will make no disclosure until the Company has had a reasonable opportunity to contest the right of the requesting person or entity to such disclosure.

8. The terms and conditions of this Agreement are and shall be deemed to be confidential, and shall not be disclosed by Executive to any person or entity without the prior written consent of the Board, except if required by law, and to Executive's accountants, attorneys, and spouse, provided that they agree to maintain the confidentiality of this Agreement. Executive further represents that he has not disclosed the terms and conditions of this Agreement to anyone other than his attorneys, accountants and spouse.

9. The making of this Agreement is not intended, and shall not be construed, as an admission that any of the Releasees has violated any federal, state or local law (statutory or decisional), ordinance or regulation, breached any contract, or committed any wrong whatsoever against Executive.

10. The parties agree that this Agreement may not be used as evidence in a subsequent proceeding except in a proceeding to enforce the terms of this Agreement.

11. Executive acknowledges that: (a) he has carefully read this Agreement in its entirety; (b) he has had an opportunity to consider fully the terms of this Agreement; (c) he has been advised by the Company in writing to consult with an attorney of his choosing in connection with this Agreement; (d) he fully understands the significance of all of the terms and conditions of this Agreement and he has discussed it with his independent legal counsel, or has had a reasonable opportunity to do so; (e) he has had answered to his satisfaction any questions he has asked with regard to the meaning and significance of any of the provisions of this Agreement; and (f) he is signing this Agreement voluntarily and of his own free will and assents to all the terms and conditions contained herein.

12. This Agreement is binding upon, and shall inure to the benefit of, the parties and their respective heirs, executors, administrators, successors and assigns.

13. If any provision of this Agreement shall be held by a court of competent jurisdiction to be illegal, void, or unenforceable, such provision shall be of no force and effect. However, the illegality or unenforceability of such provision shall have no effect upon, and shall not impair the enforceability of, any other provision of this Agreement; provided, however, that, upon any finding by a court of competent jurisdiction that the release or any of the covenants provided for by Section 5 and/or Section 6 above is illegal, void, or unenforceable, Executive agrees to execute a release, waiver and/or covenant with substantially similar provisions that is legal and enforceable. Finally, any breach of any of the terms of Sections 6, 7 and/or 8 above shall constitute a material breach of this Agreement as to which the Company may seek appropriate relief in a court of competent jurisdiction.

14. This Agreement shall be governed by, and construed and enforced in accordance with, the laws of the State of Georgia, without regard to the conflict of laws provisions thereof. Actions to enforce the terms of this Agreement, or that relate to Executive's employment with the Company, shall be submitted to the exclusive jurisdiction of any appropriate state court of record in Georgia.

15. This Agreement may be executed in multiple counterparts, each of which shall be deemed

an original and all of which together shall be considered one and the same agreement and shall become effective when one or more counterparts have been signed by each of the parties and delivered to the other party. Facsimile or .pdf signatures shall have the same force and effect as original signatures.

16. This Agreement (including any exhibits attached hereto) constitutes the complete understanding between the parties with respect to the termination of Executive's employment at the Company and supersedes any and all agreements, understandings, and discussions, whether written or oral, between the parties. No amendment of any provision of this Agreement shall be valid unless the same shall be in writing and signed by each of the parties hereto.

Dated:

Richard Rector

HEALTHCARE STAFFING, INC.

By: Date: Name:
 Title:

SUBSIDIARIES OF THE REGISTRANT

Novation Holding, Inc., a Delaware Corporation
Healthcare Staffing, Inc., a Georgia corporation
NovaStar Mortgage LLC, a Virginia limited liability company
 NovaStar Mortgage Funding Corporation, a Delaware corporation
 NovaStar REMIC Financing Corporation, a Delaware corporation
NovaStar CDO Holdings, Inc., a Delaware corporation

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements on Form S-8 (File No. 333-206184, File No. 333-196909 and File No. 333-116998) of Novation Companies, Inc. of our report dated April 10, 2018 relating to the consolidated financial statements that appear in this Annual Report on Form 10-K as of and for the year ended December 31, 2017.

/s/ BOULAY PLLP

Minneapolis, MN

April 10, 2018

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, David W. Pointer, certify that:

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

DATE: April 10, 2018

/s/ David W. Pointer

David W. Pointer

Chief Executive Officer

(Principal Executive Officer)

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Carolyn K. Campbell, certify that:

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

DATE: April 10, 2018

/s/ Carolyn K. Campbell

Carolyn K. Campbell
Chief Financial Officer
(Principal Financial Officer)

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Annual Report of Novation Companies, Inc. (the "Company") on Form 10-K for the period ended December 31, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David W. Pointer, Chief Executive Officer of the Company, certify as of the date hereof, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes - Oxley Act of 2002, that to my knowledge:

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

DATE: April 10, 2018

/s/ David W. Pointer

David W. Pointer

Chief Executive Officer

(Principal Executive Officer)

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Annual Report of Novation Companies, Inc. (the "Company") on Form 10-K for the period ended December 31, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Carolyn K. Campbell, Chief Financial Officer of the Company, certify as of the date hereof, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes - Oxley Act of 2002, that to my knowledge:

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

DATE: April 10, 2018

/s/ Carolyn K. Campbell

Carolyn K. Campbell

Chief Financial Officer

(Principal Financial Officer)