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, 2018

☐ **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	**74-2830661**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
9229 Ward Parkway, Suite 340, Kansas City, MO	**64114**
(Address of Principal Executive Office)	(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 every Interactive Data File required to be submitted 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 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, 2018 was approximately $ 1,888,796 , based upon the closing sales price of the registrant's common stock on that date ($ .03).

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 March 25, 2019 was 101,577,893 .

NOVATION COMPANIES, INC.
FORM 10-K
For the Fiscal Year ended December 31, 2018

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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. The Company has also historically owned a portfolio of mortgage securities which generated earnings to support on-going financial obligations. These securities were marketed for sale and sold for a total of $13 million during 2018. 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”) 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 will occur when all conditions precedent to effectiveness, as set forth in the Plan, have 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 and (ii) the restructuring of the Company’s then outstanding senior notes. The HCS Acquisition and the note restructuring were completed on July 27, 2017 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. On April 11, 2018, the Bankruptcy Court confirmed NMLLC's plan of reorganization. This plan allows NMLLC to exit bankruptcy, but prohibits the use of NMLLC assets for anything other than for the payment of NMLLC obligations. See Note 9 - Commitments and Contingencies for settlement information that was agreed to by NMLLC as part of its reorganization efforts. These obligations of approximately $1.5 million are captured in Note 2 - Reorganization in the numbers reported for the year ended December 31, 2018 .

Acquisition of Healthcare Staffing, Inc. On July 27, 2017, the Company completed the HCS Acquisition, acquiring all of the outstanding capital stock of HCS from Butler America, LLC (“Butler”) for approximately $24.0 million in cash, 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 21 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 2017 , 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 continued to be a source of our earnings and cash flow. Residual securities consisted of interest-only and overcollateralization bonds. Collectively, these securities are referred to as our retained mortgage securities. The Company marketed these securities for sale and sold them during 2018 for a total of $13 million.

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 March 25, 2019 , the Company employed 1,686 full-time employees and 583 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 9229 Ward Parkway, Suite 340, Kansas City, MO 64114 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 21 CSBs in Georgia and HCS conducts business with 15 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. 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 2018 , we had net income of $ 6.1 million. However, $ 12.9 million of this was attributable to one-time realized gains on the sale of mortgage securities. We also generated negative operating cashflow of $ 5.1 million. As of December 31, 2018 , we had an overall shareholders deficit of $ 63.0 million. As of December 31, 2018 , we had an aggregate of $ 9.2 million in cash and cash equivalents and total liabilities of $ 94.1 million. Of the $ 9.2 million in cash, $ 1.3 million was held by our subsidiary NMLLC, which has filed a Chapter 11 plan of reorganization that was confirmed by the court on April 11, 2018 and under such plan is prohibited from using its assets for anything other than payment of its obligations . The Company also has a significant on-going obligation to pay interest under its senior note agreement.

After engaging major investment firms to evaluate the marketplace for its mortgage securities, the Company executed trades to sell all of its mortgage securities during 2018. These sales generated $ 13.0 million in cash proceeds for the Company. However, the Company will no longer have any future cash flows from these securities since they were sold. In addition, through the date of this filing, HCS believes it 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 in the future. 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, 2018 .

As disclosed in Part II, Item 9. Controls and Procedures of this Form 10-K, our chief executive officer 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, 2018 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, 2018 , we had federal net operating losses ("NOLs") of approximately $ 729.2 million, including $ 250.3 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"). Shareholders voted to extend the NOL Rights Plan through July 20, 2021 at the Company's 2018 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, 2018 . 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.

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. Shareholders voted to extend the NOL Rights Plan through July 20, 2021 at the Company's 2018 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 1,400 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 and on October 19, 2018 dismissed the appeal as moot. Following the court of appeals’ denial of the objector’s petition for rehearing, the district court on March 7, 2019 held a fairness hearing. On March 8, 2019, the district court issued a memorandum and order approving the settlement as fair, reasonable and adequate, and dismissing the action with prejudice. Following entry of judgment, the objector filed a notice of appeal on March 26, 2019. Assuming the settlement approval becomes final, 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 approval does not become final, 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, New York County 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, rescissory 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 was completed.

The parties have reached a settlement of this matter. On October 25, 2018, the bankruptcy court overseeing the Company's bankruptcy case entered an order approving the settlement, and on November 19, 2018, the New York State Court “so ordered” a Stipulation of Voluntary Discontinuance terminating the case. Pursuant to the terms of the settlement agreement, the required upfront payment of $0.3 million was made on March 1, 2019. The settlement also requires equal quarterly installments over a three years period, which total an additional $0.3 million. Based on the probability of all contingencies associated with the settlement being satisfied, the Company has recorded an expense in the second quarter of 2018 in the Reorganization Items, net expense line item of the income statement and the short and long-term liability totals in the applicable Accrued Settlement Claims lines per the balance sheet.

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.

	High	Low
2018		
First Quarter	$ 0.10	$ 0.03
Second Quarter	0.08	0.03
Third Quarter	0.05	0.02
Fourth Quarter	0.05	0.02
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

As of March 25, 2019 , we had approximately 738 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 2018 or 2017 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, 2018 and 2017 . 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. The Company also owned a portfolio of mortgage securities which generated earnings to support on-going financial obligations.These securities were sold during 2018 for $13.0 million. See Note 6 to the consolidated financial statements for additional information regarding the sale of these securities. 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 our emergence from bankruptcy and note refinancing, which both occurred in the third quarter of 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,	
	2018	**2017**
Cash and cash equivalents	$ 9,249	$ 2,740
Marketable securities	$ 1	$ 11,795
Service fee income	$ 55,126	$ 27,965
Net income (loss) available to common shareholders, per basic share	$ 0.07	$ (0.12)

Consolidated Results of Operations

Year Ended December 31, 2018 as Compared to the Year Ended December 31, 2017

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 21 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 2018 are from the operations of HCS.

Future service fee income will be driven by the number of 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 the cost of administration.

During the first quarter of 2018 a significant customer substantially reduced the level of staff outsourced to HCS. However, HCS replaced the majority of that lost revenue with new CSB customer agreements signed during the second and third quarters of 2018. These new customers started in September 2018 and January 2019, respectively.

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 increase in these expenses during 2018 results from a full year of ownership of HCS, as compared to a partial year of ownership in 2017. During 2018 and 2017 , $ 5.8 and $ 2.8 million, respectively, of the total general and administrative expenses were incurred by HCS. Corporate-level general and administrative expenses during 2018 and 2017 were $ 2.3 million and $ 3.9 million , respectively. The reduction of professional and legal fees due to the emergence from bankruptcy was the primary reason for the decrease 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

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. There were no goodwill impairment charges for the year ended December 31, 2018 .

Interest Income – Mortgage Securities

Interest income on our mortgage securities decreased to approximately $ 1.1 million in 2018 from $ 3.1 million in 2017 . 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. During 2018, the overall interest rate increase in the market had a negative impact on the interest income received from these securities. All of our mortgage securities were sold in December 2018, and therefore t he Company will have no future interest income or cash flow from these securities.

Impairment on Mortgage Securities

To the extent that the cost basis of mortgage 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 impairment of $.3 million on the 2002-3 AIO security recorded in 2018 was primarily driven by the deteriorating credit quality of the loans underlying the security.

Other Income

Other income consists primarily of the interest, dividend, and other income received from ownership of its mortgage 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 had significantly less available funds to invest. The Company sold all of its mortgage securities in December 2018, resulting in gains on sale of $12.9 million.

	For the Years Ended December 31,	
	2018	**2017**
Interest income	$ 10	$ 230
Gains on sales of investments	12,881	137
Other	401	(19)
Total	$ 13,292	$ 348

Reorganization items, net

The Company has incurred significant costs associated with our reorganization and the Chapter 11 proceedings, which primarily consists of legal fees, and are expensed as incurred. These costs have decreased significantly as a result of the completion of the Company's Reorganization efforts and will continue to decrease significantly in 2019. Reorganization items include (in thousands):

	For the Years Ended December 31,	
	2018	**2017**
Professional fees	$ (374)	$ (3,460)
Adjustments to other liabilities for claims made or rejected contract	(1,490)	(87)
Other	-	(34)
Reorganization items, net	$ (1,864)	$ (3,581)

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 $ 5.3 million in 2018 from $ 3.9 million in 2017 . The increase in interest expense is a result of an increase in LIBOR.

Liquidity and Capital Resources

During 2018 , the Company had net income of $ 6.1 million and generated negative operating cash flow of $ 5.1 million . As of December 31, 2018 the Company has an overall shareholders deficit of $ 63.0 million . As of December 31, 2018 , the Company had an aggregate of $ 9.2 million in cash and cash equivalents and total liabilities of $ 94.1 million . Of the $ 9.2 million in cash, $ 1.3 million is held by the Company's subsidiary NMLLC, which has filed a Chapter 11 plan of reorganization that was confirmed by the court on April 11, 2018 . Under this plan, this cash is only available to pay general creditors and expenses of NMLLC. The Company also has a significant ongoing obligation to pay interest under its senior note agreement.

On November 17, 2017, HCS entered into a Revolving Credit and Security Agreement, dated as of the same date (the “White Oak Credit Agreement”), with White Oak Global Advisors, LLC ("White Oak'), providing HCS with a line of credit of up to $5,000,000. The credit agreement was originally with Federal National Payables, Inc. (d/b/a Federal National Commercial Credit) (“FNCC”), which White Oak acquired in February 2018. The obligations of HCS under the White Oak Credit Agreement are secured by HCS’s inventory and accounts receivable. Availability under the White Oak Credit Agreement is based on a formula tied to HCS’s eligible accounts receivable, and borrowings under the White Oak Credit Agreement bear interest at the prime rate plus 1.25%. The White Oak Credit Agreement also provides for customary origination and collateral monitoring fees payable to White Oak during its term. The White Oak Credit Agreement contains customary representations, warranties and affirmative and negative covenants, including but not limited to financial covenants. The White Oak 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, White Oak may, among other remedies, accelerate payment of all obligations under the White Oak Credit Agreement. In connection with the White Oak Credit Agreement, the Company executed a guaranty in favor of White Oak guaranteeing all of HCS’s obligations under the White Oak Credit Agreement.

The initial term of the White Oak Credit Agreement expired on November 17, 2018, but was renewed automatically for a consecutive one-year term per the provisions of the agreement. HCS terminated the White Oak Credit Agreement in February 2019 and the Company fully repaid the all the outstanding obligations at that time.

After engaging major investment firms to evaluate the marketplace for its mortgage securities, the Company executed trades to sell all of its mortgage securities during 2018. These sales generated $ 13.0 million in cash proceeds for the Company. However, the Company will no longer have any future cash flows from these securities since they were sold. In addition, through the date of this filing, HCS believes it 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, 2018

The following table provides a summary of our operating, investing and financing cash flows as taken from our consolidated statements of cash flows for 2018 and 2017 (in thousands).

	For the Years Ended December 31,	
	2018	**2017**
Cash flows used in operating activities of continuing operations	$ (5,056)	$ (9,621)
Cash flows provided by investing activities of continuing operations	13,031	3,510
Cash flows (used in) provided by financing activities of continuing operations	(1,466)	3,151

Operating Activities

The decrease in net cash flows used from operating activities from continuing operations to approximately $ 5.1 million used during 2018 from approximately $ 9.6 million used during 2017 was driven primarily by the net income and a decrease in the Company's accounts and unbilled receivables.

Investing Activities

The increase in the net cash flows provided by investing activities is due to proceeds from the sales of marketable securities.

Financing Activities

During 2017, HCS entered into the White Oak Credit Agreement providing HCS with a line of credit of up to $5,000,000. Availability under the White Oak 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 2018 . HCS terminated the White Oak Credit Agreement in February 2019 and the Company fully repaid the all the outstanding obligations at that time.

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.

For periods prior to June 30, 2018, in order to determine value, our process was to 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.

For the period of June 30, 2018 and after, the Company engaged a broker to market and sell the interest-only and overcollateralization bonds. Through this broker and the subsequent sale of portions of these securities, the Company determined that a market of buyers exists for these securities. As a result, in the second quarter of 2018, the Company reassessed the previous valuation methodology and changed the valuation methodology from a discounted cash flow approach to a market-based approach

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

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

NOVATION COMPANIES, INC. AND SUBSIDIARIES

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, 2018 and 2017 , and the related consolidated statements of operations and comprehensive income (loss), stockholders' deficit, and cash flows for each of the years in the two year period ended December 31, 2018 , 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, 2018 and 2017 , and the results of its operations and its cash flows for each of the years in the two year period ended December 31, 2018 , in conformity with accounting principles generally accepted in the United States of America.

Change in Accounting Principle

As discussed in Note 1 to the consolidated financial statements, the Company has changed its method of accounting for revenue in 2018 due to the adoption of FASB Accounting Standards Codification (Topic 606), *Revenue from Contracts with Customers* .

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

March 25, 2019

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

	December 31, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 9,249	$ 2,740
Accounts and unbilled receivables	6,122	7,922
Marketable securities	1	11,795
Other	480	578
Total current assets	15,852	23,035
Non-current assets:		
Goodwill	8,205	8,205
Intangible assets, net	6,978	8,172
Other	95	425
Total non-current assets	15,278	16,802
Total assets	$ 31,130	$ 39,837
Liabilities and Shareholders' Deficit		
Current liabilities:		
Accounts payable and current maturities of long-term debt	$ 657	$ 1,645
Accrued compensation and benefits payable	2,731	4,213
Borrowings under revolving line of credit	1,948	3,333
Accrued interest payable	1,295	1,050
Accrued professional fees payable	13	1,037
Accrued claim settlements	459	—
Other	35	5
Total current liabilities	7,138	11,283
Non-current liabilities:		
Long-term debt	85,969	86,050
Accrued claim settlements	553	—
Other	426	386
Total non-current liabilities	86,948	86,436
Total liabilities	94,086	97,719
Shareholders' deficit:		
Common stock, $.01 par value per share, 780,000,000 shares authorized: 99,137,893 and 97,138,750 shares issued and outstanding as of December 31, 2018 and 2017, respectively	991	971
Additional paid-in capital	745,104	744,937
Accumulated deficit	(809,050)	(815,184)
Accumulated other comprehensive income (loss)	(1)	11,394
Total shareholders' deficit	(62,956)	(57,882)
Total liabilities and shareholders' deficit	$ 31,130	$ 39,837

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 Years Ended December 31, 2018	2017
Service fee income	$ 55,126	$ 27,965
Cost and expenses:		
Cost of services	48,149	24,473
General and administrative expenses	8,089	6,713
Goodwill impairment charge	—	4,500
Operating loss	(1,112)	(7,721)
Interest income - mortgage securities	1,133	3,143
Impairment on mortgage securities	(325)	—
Gains on sales of investments	12,881	137
Other income	411	211
Interest expense	(5,279)	(3,935)
Reorganization items, net	(1,864)	(3,581)
Income (loss) from continuing operations before income taxes	5,845	(11,746)
Income tax expense (benefit), continuing operations	(289)	14
Net income (loss) from continuing operations	6,134	(11,760)
Income from discontinued operations, net of income taxes	—	895
Net income (loss)	6,134	(10,865)
Other comprehensive income (loss):		
Reclassification gain on marketable securities included in net income	(12,881)	(137)
Unrealized gains on marketable securities – available-for-sale	1,486	2,212
Total other comprehensive income (loss)	(11,395)	2,075
Total comprehensive loss	$ (5,261)	$ (8,790)
Earnings (loss) per share:		
Basic	$ 0.07	$ (0.12)
Diluted	$ 0.06	$ (0.12)
Weighted average common shares outstanding:		
Basic	93,961,799	92,800,392
Diluted	94,470,057	92,800,392

See notes to consolidated financial statements.

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, 2017	$ 971	$ 744,937	$ (815,184)	$ 11,394	$ (57,882)
Issuances and cancellations of nonvested shares	20	(20)	—	—	—
Compensation recognized under stock compensation plans	—	187	—	—	187
Net income	—	—	6,134	—	6,134
Other comprehensive loss	—	—	—	(11,395)	(11,395)
Balance, December 31, 2018	$ 991	$ 745,104	$ (809,050)	$ (1)	$ (62,956)
Balance, December 31, 2016	$ 928	$ 744,873	$ (804,319)	$ 9,319	$ (49,199)
Issuances and cancellations 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	$ 971	$ 744,937	$ (815,184)	$ 11,394	$ (57,882)

See notes to consolidated financial statements.

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

	For the Years Ended December 31, 2018	2017
Cash flows from operating activities:		
Net income (loss)	$ 6,134	$ (10,865)
Net income from discontinued operations	—	895
Net income (loss) from continuing operations	6,134	(11,760)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Goodwill impairment	—	4,500
Accretion of marketable securities, net	(76)	58
Impairment on mortgage securities	325	—
Amortization of intangible assets	1,194	496
Realized gain on marketable securities	(12,881)	(137)
Settlement claims	1,012	—
Depreciation expense	334	264
Compensation recognized under stock compensation plans	187	107
Changes in operating assets and liabilities, net of acquisition:		
Accounts and unbilled receivables	1,800	(457)
Accounts payable and accrued expenses	(988)	589
Accrued professional fees payable	(1,024)	346
Accrued compensation and benefits payable	(1,482)	(613)
Accrued interest payable	245	(2,639)
Other current assets and liabilities, net	128	(526)
Other noncurrent assets and liabilities, net	36	151
Net cash used in operating activities from continuing operations	(5,056)	(9,621)
Net cash provided by operating activities of discontinued operations	—	895
Net cash used in operating activities	(5,056)	(8,726)
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	13,031	26,847
Purchase of business, net of cash received	—	(23,337)
Net cash provided by investing activities	13,031	3,510
Cash flows from financing activities:		
Borrowings under revolving line of credit	55,537	10,043
Repayments of borrowings under revolving line of credit	(56,922)	(6,710)
Paydowns of long-term debt	(81)	(182)
Net cash provided by (used in) financing activities	(1,466)	3,151
Net increase (decrease) in cash and cash equivalents - continuing operations	6,509	(2,065)
Cash and cash equivalents of continuing operations, beginning of period	2,740	4,805
Cash and cash equivalents of continuing operations, end of period	$ 9,249	$ 2,740

	For the Years Ended December 31,	
	2018	2017
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 5,034	$ 6,557
Cash paid for reorganization items	$ 1,175	$ 4,501
Cash paid for income taxes, net	$ 75	$ —
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.

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 previously owned a portfolio of mortgage securities which generated earnings to support on-going financial obligations through the end of 2018. The mortgage securities were sold during 2018 for a total of $13 million. 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".

Management of the Company measures financial performance based on the results of the Company as a whole and not based on the performance of the Company's investments and HCS.

Liquidity and Going Concern – During 2018 , the Company earned net income of $ 6.1 million and generated negative operating cashflow of $ 5.1 million. As of December 31, 2018 the Company has an overall shareholders deficit of $ 63.0 million. As of December 31, 2018 , the Company had an aggregate of $ 9.2 million in cash and cash equivalents and total liabilities of $ 94.1 million. Of the $ 9.2 million in cash, $ 1.3 million is held by the Company's subsidiary NovaStar Mortgage LLC ("NMLLC") . This cash is available only to pay only general creditors and expenses of NMLLC. The Company also has a significant on-going obligation to pay interest under its senior note agreement. During the first quarter of 2018 a significant customer substantially reduced the level of staff outsourced to HCS. However, HCS replaced the majority of that lost revenue with new CSB customer agreements signed during the second and third quarters of 2018. These new customers started in September 2018 and January 2019. These events have led to substantial doubt about the ability of the Company to continue as a going concern.

After engaging major investment firms to evaluate the marketplace for its mortgage securities, the Company executed trades to sell all of its mortgage securities during 2018. These sales generated $ 13.0 million in cash proceeds for the Company. For the year ended December 31, 2018, the Company recorded $ 12.9 million in gains in other income in the Statements of Operations and Comprehensive Income (Loss) related to the sale of these securities. However, the Company will no longer have any future cash flows from these securities since they were sold. In addition, through the date of this filing, HCS believes it 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.

Management continues to work toward expanding HCS's operations by building their customer base. This includes increasing revenue from existing customers in the Community Service Boards ("CSBs") market and also targeting new customers, which 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 cash flow 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, Novation and three of its subsidiaries, NMLLC, NovaStar Mortgage Funding Corporation ("NMFC") and 2114 Central LLC, filed voluntary 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 for the resolution of the outstanding claims against and interests pursuant to Section 1121(a) of the Bankruptcy Code (as amended as 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 will occur when all conditions precedent to effectiveness, as set forth in the Plan, have 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 and (ii) the restructuring of the Company's then outstanding senior notes. The HCS Acquisition and the note restructuring were completed on July 27, 2017 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. 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. On April 11, 2018, the Bankruptcy Court confirmed NMLLC's plan of reorganization. This plan allows NMLLC to exit bankruptcy, but prohibits the use of NMLLC assets for anything other than for the payment of NMLLC obligations. See Note 9 - Commitments and Contingencies for settlement information that was agreed to by NMLLC as part of its reorganization efforts. These obligations of approximately $1.5 million are captured below in the numbers reported for the year ended December 31, 2018 .

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

	Years Ended December 31,	
	2018	**2017**
Professional fees	$ (374)	$ (3,460)
Adjustments to other liabilities for claims made or rejected contracts	(1,490)	(87)
Other	-	(34)
Reorganization items, net	$ (1,864)	$ (3,581)

Note 3. Summary of Significant Accounting and Reporting Policies

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 $ 8.6 million as of December 31, 2018 .

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 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. For periods prior to June 30, 2018, retained mortgage-backed securities were valued at each reporting date using significant unobservable inputs (Level 3) by discounting the expected cash flows. An independent valuation specialist was 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. During 2018, the Company engaged a broker to market and sell the interest-only and overcollateralization bonds. Through this broker and the subsequent sale of portions of these securities, the Company determined that a market of buyers exists for these securities. As a result, in the second quarter of 2018, the Company reassessed the previous valuation methodology and changed the valuation methodology from a discounted cash flow approach to a market-based approach. The Company determined the market for these securities is not an active market with quotes available to participants, but is instead based on quotes of similar investments. As a result, these investments now qualify as Level 2 investments for reporting purposes. See Note 10 to the consolidated financial statements for additional information on the estimates used in the valuation of our retained mortgage securities.

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 control of the promised services is transferred to customers and for the amount that reflects the consideration we are entitled to receive in exchange for those services. Furthermore, revenue is recognized over time based on a fixed amount for each hour of staffing service provided as our customers benefit from our services and as we provide them. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer. A contract’s transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The Company’s customer contracts have a single performance obligation to transfer the individual goods or services, and it is not separately identifiable from other promises in the contracts and is, therefore, not distinct. Performance obligations are satisfied at the point in time the HCS employees work on behalf of the customer. Contract costs include compensation, benefits and overhead when appropriate. Because of the nature of the contracts and the fact that revenue is earned at the time the employee works for the customer, no contract estimates are necessary.

Income Taxes. The Company had a gross deferred tax asset of $ 164.0 million and $ 164.7 million as of December 31, 2018 and 2017 , 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.

Recently Issued and Adopted Accounting Principles

On January 1, 2018, the Company adopted new accounting guidance on revenue recognition prescribed by Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic 606, Revenue from Contracts with Customers. We used the modified retrospective approach applied to those customer contracts that were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under the new guidance, while prior periods continue to be reported in accordance with previous accounting guidance. We determined that no cumulative effect adjustment to accumulated deficit was necessary upon adoption as there were no significant revenue recognition differences identified between the new and previous accounting guidance.

In April 2015, the FASB issued Accounting Standards Update (ASU) 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement* , or ASU 2015-05. ASU 2015-05 amends existing accounting guidance to provide explicit guidance related to a customer's accounting for fees paid in a cloud computing arrangement. Under the guidance, cloud computing arrangements that include a software license would be accounted for consistent with the acquisition of other software licenses. Conversely, cloud computing arrangements that do not include a software license would be accounted for as a service contract. The Company adopted ASU 2015-05 effective January 1, 2018 and there was no impact on the presentation of its results of operations, financial position or disclosures.

In June 2018, the FASB issued ASU No. 2018-07, Improvements to Nonemployee Share-Based Payment Accounting, which expands the scope of ASC 718, Compensation – Stock Compensation, to include share-based payment transactions for acquiring goods and services from nonemployees and to supersede the guidance in ASC 505-50. The new guidance will be substantially the same as current guidance for employee awards. The Company adopted this standard April 1, 2018 and applied it using the modified retrospective approach. The remeasurement of open awards to nonemployees was based on the fair value of such awards as of the date of adoption and resulted in no material change to accumulated deficit or additional paid-in capital.

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 estimates adoption of the standard will result in recognition of additional net lease assets and lease liabilities of approximately $0.2 million and $0.2 million, respectively, as of January 1, 2019. The difference between these amounts will be recorded as an adjustment to retained earnings. The Company does not believe the standard will materially affect our consolidated net earnings.

In August 2018, the SEC adopted the final rule under SEC Release No. 33-10532, Disclosure Update and Simplification, amending certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. In addition, the amendments expanded the disclosure requirements on the analysis of stockholders' equity for interim financial statements. Under the amendments, an analysis of changes in each caption of stockholders' equity presented in the balance sheet must be provided in a note or separate statement. The analysis should present a reconciliation of the beginning balance to the ending balance of each period for which a statement of operations and comprehensive income (loss) is required to be filed. The Company anticipates its first presentation of year-to-date quarterly changes in shareholders' deficit will be included in its Form 10-Q for the quarter ending March 31, 2019.

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 former 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. 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.

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 have held 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. As part of the HCS Purchase Agreement, Novation purchased a Buyer-Side Representations and Warranties Insurance Policy ("reps and warranties insurance") covering the acquisition. In regards to the claims filed against Butler, the Company also filed a claim under the reps and warranties insurance. A settlement was reached with the reps and warranties insurers during the fourth quarter of 2018 and the Company received $.5 million in relation to this claim.

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	$	23,583

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 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 2018 year to date consolidated statement of operations and comprehensive loss. 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, 2017 (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
Service fee income	$	63,246
Loss from continuing operations before taxes	$	(9,331)
Net loss	$	(8,450)
Basic and diluted loss per share:		
Net loss from continuing operations	$	(0.10)
Net loss	$	(0.09)

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 Years Ended December 31,			
	2018		2017	
Recognition of gain upon release of indemnification escrow - Corvisa sale	$	-	$	1,020
Expenses related to discontinued operations		-		(125)
Income from discontinued operations, net of income taxes	$	-	$	895

The assets and liabilities of discontinued operations are not material.

Note 5. Revenue; Accounts and Unbilled Receivables

Staffing services include the augmentation of customers' workforce with our contingent employees performing services under the customers' supervision, which provides our customers with a source of flexible labor at a competitive cost. Customer contracts are typically annual contracts but may be terminated upon 60 days' notice for any reason.

Contract Balances — The timing of revenue recognition, billings and cash collections results in accounts receivable and unbilled receivables (the "Contract Assets"). The Company bills customers generally every other week based on the work performed during the two-week period ended the week prior to billing. Generally, billing occurs after revenue recognition, resulting in Contract Assets. The Company does not receive advances or deposits from its customers.

Disaggregation of Revenue — All revenue is generated from customers that provide healthcare services in Georgia. The following is a disaggregation of the Company’s revenue, in thousands, into categories that best depict how the nature, amount, timing, and uncertainty of revenues and cash flows are affected by economic factors.

	For the Year Ended December 31, 2018		
Type of Customer			
CSB	$	52,491	95.2%
Other		2,635	4.8%
Total	$	55,126	100.0%

Accounts and unbilled receivables are summarized as follows, in thousands:

	December 31, 2018		December 31, 2017	
Accounts receivable	$	3,952	$	5,418
Unbilled receivables (Contract Assets)		2,170		2,504
Total accounts and unbilled receivables	$	6,122	$	7,922

As of December 31, 2018 and December 31, 2017 management has determined no allowance for doubtful accounts is necessary. For the years ended December 31, 2018 and December 31, 2017 , 44.6% and 56.9% of service fee income was generated from two and three customers, respectively. As of December 31, 2018 , 60.9% of accounts and unbilled receivables was due from four customers and 95.3% was due from 14 CSB customers. As of December 31, 2017 , 61.1% of accounts and unbilled receivables was due from four customers and 96.6% was due from 15 CSB customers.

Note 6. Marketable Securities

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

			Gross Unrealized					
	Amortized Cost		Gains		Losses		Estimated Fair Value	
As of December 31, 2018								
Marketable securities, current								
Mortgage securities	$	-	$	-	$	-	$	-
Equity securities		2		-		(1)		1
Total	$	2	$	-	$	(1)	$	1
As of December 31, 2017								
Marketable securities, current								

Mortgage securities	$ 400	$ 11,394	$ -	$ 11,794
Equity securities	1	-	-	1
Total	$ 401	$ 11,394	$ -	$ 11,795

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

During 2018, the Company sold all but 33 non-performing mortgage securities. These sales generated proceeds of $13.0 million and realized gains of $12.9 million recognized, included in other income in the Company's consolidated statements of operations and comprehensive income (loss). Of the 33 retained, the Company determined that these securities have no fair value. There were other-than-temporary impairments relating to available-for-sale securities in 2018 of $0.3 million.

Prior to 2017, 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 held mortgage securities that continued to be a source of earnings and cash flow through December 2018. As of December 31, 2017, 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.

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

	Size/Principal Outstanding (A)	Assets on Balance Sheet (B)	Liabilities on Balance Sheet	Maximum Exposure to Loss	Year to Date Loss on Sale	Year to Date Cash Flows
December 31, 2018	$ -	$ -	$ -	$ -	$ -	$ 1,057
December 31, 2017	$ 2,714,823	$ 11,794	$ -	$ 11,794	$ -	$ 3,193

(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.

As part of the mortgage securitization process, the Company owned the mortgage servicing rights on the mortgage loans in each securitization deal. These servicing rights were sold to a third party on October 12, 2007 as documented in the Servicing Rights Transfer Agreement by and between Saxon Mortgage Services as purchaser and NovaStar Mortgage, Inc. as seller, which was discussed in the Company's third quarter 2007 report on Form 10-Q. As part of this transaction, the Company retained the clean-up call rights for most of the securitization deals. The Company also attempted to sell the clean-up call rights along with the securities that were sold, as noted above. However, no bids were received for the clean-up call rights and the Company does not believe they have any fair value.

Note 7. Goodwill and Intangible Assets

	December 31, 2018			December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Indefinite-lived assets (in thousands)						
Goodwill	$ 8,205	$ -	$ 8,205	$ 8,205	$ -	$ 8,205
Tradenames	1,147	-	1,147	1,147	-	1,147
	$ 9,352	$ -	$ 9,352	$ 9,352	$ -	$ 9,352
Finite-lived assets (in thousands)						
Customer relationships	$ 6,895	$ 1,395	$ 5,500	$ 6,895	$ 410	$ 6,485
Non-compete agreement	627	296	331	627	87	540
	$ 7,522	$ 1,691	$ 5,831	$ 7,522	$ 497	$ 7,025

	Years Ended December 31,	
	2018	2017
Goodwill activity (in thousands):		
Beginning balance	$ 8,205	$ -
Goodwill recorded in connection with the HCS Acquisition	-	12,705
Impairment charge	-	(4,500)
Ending balance	$ 8,205	$ 8,205

As part of the goodwill impairment analysis completed annually on April 30th of each year, Management concluded no impairment was necessary for 2018 as a result of this review. In addition, Management has determined no impairment of indefinite and definite lived intangible assets existed as of December 31, 2018.

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)		
2018	$	1,194
Estimated future amortization expense (in thousands)		
2019	$	1,194
2020		1,107
2021		985
2022		985
Thereafter		1,560
Total estimated amortization expense	$	5,831

Note 8. Borrowings

Revolving Credit Agreement. As of December 31, 2018 , HCS had $ 1.9 million outstanding under the White Oak Credit Agreement. This agreement provides HCS with a line of credit of up to $5,000,000. The obligations of HCS under the White Oak Credit Agreement are secured by HCS's inventory and accounts receivable. Availability under the White Oak Credit Agreement is based on a formula tied to HCS's eligible accounts receivable. Borrowings, and borrowings under the White Oak Credit Agreement bear interest at the prime rate plus 1.25%. The White Oak Credit Agreement also provides for customary origination and collateral monitoring fees payable to White Oak.

The White Oak Credit Agreement contains customary representations, warranties and affirmative and negative covenants, including but not limited to financial covenants. The White Oak 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, White Oak may, among other remedies, accelerate payment of all obligations under the White Oak Credit Agreement. In connection with the White Oak Credit Agreement, the Company executed a guaranty in favor of White Oak guaranteeing all of HCS's obligations under the White Oak Credit Agreement.

The initial term of the White Oak Credit Agreement expired on November 17, 2018, but was renewed automatically for a consecutive one-year term per the provisions of the agreement. HCS terminated the White Oak Credit Agreement in February 2019 and the Company fully repaid the outstanding obligations at that time.

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 in 2017.

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.

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 and on October 19, 2018 dismissed the appeal as moot. Following the court of appeals’ denial of the objector’s petition for rehearing, the district court on March 7, 2019 held a fairness hearing. On March 8, 2019, the district court issued a memorandum and order approving the settlement as fair, reasonable and adequate, and dismissing the action with prejudice. Following entry of judgment, the objector filed a notice of appeal on March 26, 2019. Assuming the settlement approval becomes final, 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 approval does not become final, 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, New York County 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, rescissory 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 was completed.

The parties have reached a settlement of this matter. On October 25, 2018, the bankruptcy court overseeing the Company's bankruptcy case entered an order approving the settlement, and on November 19, 2018, the New York State Court "so ordered" a Stipulation of Voluntary Discontinuance terminating the case. Pursuant to the terms of the settlement agreement, the required upfront payment of $0.3 million was made on March 1, 2019. The settlement also requires equal quarterly installments over a three years period, which total an additional $0.3 million. Based on the probability of all contingencies associated with the settlement being satisfied, the Company recorded an expense in the second quarter of 2018 in the Reorganization Items, net expense line item of the income statement and the short and long-term liability totals in the applicable Accrued Settlement Claims lines per the balance sheet.

DB Structured Products, Inc., Deutsche Bank AG, Deutsche Bank National Trust Company, Deutsche Bank Securities Inc., Greenwich Capital Derivatives, Inc., RBS Acceptance Inc., RBS Financial Products Inc., RBS Securities Inc., The Royal Bank of Scotland PLC, Wachovia Investment Holdings, LLC, Wells Fargo & Company, Wells Fargo Advisors, LLC, Wells Fargo Bank, N.A. and Wells Fargo Securities, LLC (collectively, the "Indemnity Claimants") filed proofs of claim in the Company's bankruptcy case asserting the right to be indemnified by the Company for, and/or to receive contribution from the company in respect of, certain liabilities incurred as a result of their roles in the issuance of residential mortgage-backed securities sponsored by the Company. The Company filed an objection in the bankruptcy case seeking to disallow and expunge the Indemnity Claimants' proofs of claim. The Indemnity Claimants' claims were not discharged by the confirmation of the Company's plan of reorganization, and the bankruptcy court has not ruled on the Company's objection to those claims.

The parties have reached a settlement in this matter, which was approved by the court on November 29, 2018. This settlement includes an upfront payment of $0.5 million, which was paid on December 21, 2018. In addition, the settlement provides for equal quarterly installments over a three years period, which total an additional $0.4 million. Based on the probability of this settlement receiving court approval, the Company recorded an expense during the second quarter of 2018 in the Reorganization Items, net expense line item of the income statement and the short and long-term liability totals in the applicable Accrued Settlement Claims lines per the balance sheet.

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 Company's assets and liabilities which are measured at fair value on a recurring basis, include (in thousands):

		Fair Value Measurements at Reporting Date Using:		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Marketable securities, current:				
December 31, 2018	$ 1	$ 1	$ -	$ -
December 31, 2017	$ 11,795	$ 1	$ -	$ 11,794

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.

For periods prior to June 30, 2018, retained mortgage-backed securities were valued at each reporting date using significant unobservable inputs (Level 3) by discounting the expected cash flows. An independent valuation specialist was 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.

During 2018, the Company engaged a broker to market and sell the interest-only and overcollateralization bonds. Through this broker and the subsequent sale of portions of these securities, the Company determined that a market of buyers exists for these securities. As a result, in the second quarter of 2018, the Company reassessed the previous valuation methodology and changed the valuation methodology from a discounted cash flow approach to a market-based approach. The Company determined the market for these securities is not an active market with quotes available to participants, but is instead based on quotes of similar investments. As a result, these investments now qualify as Level 2 investments for reporting purposes.

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 . Mortgage securities include investments that were retained during the Company's lending and securitization process, conducted prior to 2017. 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. 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.

As discussed in Note 1, the Company sold all but 33 non-performing mortgage securities in 2018. 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.

For periods prior to June 30, 2018, 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:

	December 31, 2017
Weighted average:	
Loss severity	62.1%
Default rate	2.0%
Prepayment speed	13.5%
Servicer's optional redemption date	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 Years Ended December 31, 2018	For the Years Ended December 31, 2017
Balance, beginning of period	$ 11,794	$ 9,791
Increases (decreases) to mortgage securities – available-for-sale:		
Accretion	151	-
Proceeds from paydowns of securities (A)	(93)	(51)
Gains realized upon sale of mortgage securities	(2,931)	-
Market value adjustment (B)	(1,801)	2,054
Securities transferred from Level 3 to Level 2	(7,120)	-
Net decrease to level 3 mortgage securities – available-for-sale	(11,794)	2,003
Balance, end of period	$ -	$ 11,794

(A) Cash received on mortgage securities with no cost basis was $ 0.9 million and $ 2.8 million during 2018 and 2017 , respectively.
(B) The market value decrease shown is based on the normal decline in the security values based on the reduction of the future cash flows over time.

The following table provides 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 carrying value approximates their fair value.

The estimated fair values of the Company's financial instruments are as follows as of December 31, 2018 and 2017 (in thousands):

	As of December 31, 2018		2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Marketable securities	$ 1	$ 1	$ 11,795	$ 11,795
Financial liabilities:				
Senior notes	$ 85,938	$ 24,659	$ 85,938	$ 23,018

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 2 methodologies for the marketable securities, such as bids from buyers on the securities. The senior notes utilize 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. The debt balance from the revolving credit agreement is recorded in the consolidated balance sheet at an amount which approximates its fair value. No liabilities have been transferred between levels during any period presented. As disclosed above, the value of the marketable securities transferred from a Level 3 methodology as of December 31, 2017 to a Level 2 methodology for the second quarter of 2018.

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.

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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 2018 for Goodwill, the Company's only Level 3 asset, measured on a nonrecurring basis is included in the following table (in thousands):

Goodwill Activity:	
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 2018 and 2017 (dollars in thousands, except share and per share amounts) are as follows:

	For the Years Ended December 31,	
	2018	2017
Numerator, in thousands:		
Net income (loss) from continuing operations	$ 6,134	$ (11,760)
Net income from discontinued operations	$ -	895
Net income (loss) available to common shareholders	$ 6,134	$ (10,865)
Denominator:		
Weighted average common shares outstanding – basic	93,961,799	92,800,392
Weighted average common shares outstanding – dilutive:		
Weighted average common shares outstanding – basic	93,961,799	92,800,392
Stock options	—	—
Nonvested shares	508,258	—
Weighted average common shares outstanding – dilutive	94,470,057	92,800,392
Basic earnings (loss) per share:		
Net income (loss) from continuing operations	$ 0.07	$ (0.13)
Net income from discontinued operations	-	0.01
Net income (loss) available to common shareholders	$ 0.07	$ (0.12)
Diluted earnings (loss) per share:		
Net income (loss) from continuing operations	$ 0.06	$ (0.13)
Net income from discontinued operations	-	0.01
Net income (loss) available to common shareholders	$ 0.06	$ (0.12)

Options to purchase shares of common stock were outstanding during each period as presented below (in thousands, except exercise price), but were not included in the computation of diluted earnings (loss) per share because the number of shares assumed to be repurchased was greater than the number of shares to be obtained upon exercise, therefore, the effect would be anti-dilutive.

	For the Years Ended December 31,	
	2018	2017
Number of stock options	72	1,411
Weighted average exercise price of stock options	$ 1.17	$ 0.89

There have been no options granted during 2017 or 2018 . During 2017, the Company granted 4.3 million shares to directors, officers and other members of management, of which 2.3 million vested, 1.1 million were forfeited and 0.8 million remaining outstanding to vest in 2019 and 2020, assuming the grantees are still employees or directors of the Company as of the vest date. During 2018 , the Company granted 3.3 million shares to the Board. All of these shares will vest in 2019, assuming the grantees are still directors at the vest date. As of December 31, 2018 and 2017 , respectively, the Company had approximately 4.2 million and 4.3 million non-vested shares outstanding. The weighted average impact of 0.8 million and 1.1 million non-vested shares were not included in the calculation of earnings per share for 2018 and 2017 , 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 Years Ended December 31,	
	2018	2017
Current:		
Federal	$ (113)	$ (1)
State and local	(176)	15
Total current	$ (289)	$ 14

Below is a reconciliation of the expected federal income tax expense (benefit) using the federal statutory tax rate of 21% to the Company’s actual income tax benefit and resulting effective tax rate (in thousands).

	For the Years Ended December 31,	
	2018	2017
Income tax expense (benefit) at statutory rate	$ 984	$ (3,802)
State income taxes, net of federal tax benefit	36	(54)
Valuation allowance	(688)	(131,234)
Change in federal tax rate	-	33,640
Change in state tax rate	-	100,899
Bankruptcy reorganization	17	746
Uncertain tax positions	(371)	(4)
Other	(267)	(177)
Total income tax expense (benefit)	$ (289)	$ 14

Prior to 2017, the Company concluded that it was no longer more likely than not that it would realize a portion of its deferred tax assets. As such, the Company maintained a full valuation allowance against its net deferred tax assets as of both December 31, 2018 and 2017 .

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, 2018 and 2017 , the Company maintained a valuation allowance of $164.0 million and $162.7 million, respectively, for its deferred tax assets.

Significant components of the Company's deferred tax assets and liabilities as of December 31, 2018 and 2017 are (in thousands):

	December 31, 2018	December 31, 2017
Deferred tax assets:		
Basis difference – investments	$ -	$ 8,015
Federal NOL carryforwards	153,139	145,608
State NOL carryforwards	9,016	8,301
Other	1,866	2,756
Gross deferred tax asset	164,021	164,680
Valuation allowance	(163,992)	(162,708)
Deferred tax asset	30	1,972
Deferred tax liabilities:		
Other	30	1,972
Deferred tax liability	30	1,972
Net deferred tax asset	$ -	$ -

As of December 31, 2018 , the Company had a federal NOL of approximately $729.2 million, including $ 250.3 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. Due to tax reform enacted in 2017, NOLs created after 2017 carry forward indefinitely; the portion of NOLs that will not expire is $94.6 million. 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 2018 and as late as 2037.

The activity in the accrued liability for unrecognized tax benefits for the years ended December 31, 2018 and 2017 was (in thousands):

	For the Years Ended December 31, 2018	For the Years Ended December 31, 2017
Beginning balance	$ 328	$ 331
Gross increases – tax positions in current period	1	22
Lapse of statute of limitations	(318)	(25)
Ending balance	$ 11	$ 328

Accounting for income taxes, including uncertain tax positions, represents management's best estimate of various events and transactions, and requires significant judgment. As of December 31, 2018 and 2017 , the total gross amount of unrecognized tax benefits was $ 0.1 million and $ 0.3 million, respectively, 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 2018 and 2017 . There were accrued interest and penalties of less than $0.1 million as of both December 31, 2018 and 2017 . 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 2015 to 2018 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 chief executive officer 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 chief executive officer 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, 2018 , 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, 2018 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, 2018 .

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

On March 22, 2019, Richard M. Rector, President of HCS., provided notice to the Company of his resignation from his position with HCS, effective 30 days after the date of such notice.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

DIRECTORS AND EXECUTIVE OFFICERS

Howard M. Amster , age 71, 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. 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.

Howard Timothy Eriksen , age 50, has been a member of the Board since April 2018. Mr. Eriksen has been the Chief Executive Officer and Interim Chief Financial Officer of Solitron Devices, Inc. ("Solitron"), a manufacturer of solid-state semiconductor components, since July 2016. Mr. Eriksen also serves as the Managing Member of Eriksen Capital Management LLC ("ECM"), a Lynden, Washington based investment advisory firm that he founded in 2005. Previously, Mr. Eriksen worked for Walker's Manual, Inc., a publisher of books and newsletters on micro-cap stocks, unlisted stocks and community banks, from 2004 to 2005, and prior to that for Kiewit Pacific Co, a subsidiary of Peter Kiewit Sons, a construction and mining services company, as an administrative engineer on the Benicia Martinez Bridge project. Mr. Eriksen has been a member of the board of directors of Solitron since August 2015. Mr. Eriksen received a Bachelor of Arts from The Master's University and a Master of Business Administration from Texas A&M University. The Board believes that Mr. Eriksen's qualifications to serve on the Board include his financial expertise and operating experience at other small-cap companies.

Barry A. Igdaloff , age 64, 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.

Lee D. Keddie , age 50, has been a member of the Board since April 2018. Mr. Keddie has been President and Chief Executive Officer of CompuMed Inc. (OTC:CMPD) ("CompuMed"), an enterprise telemedicine solutions company, since November 2015. In addition, he has been President and Chief Executive Officer of Value Creation Management Group LLC, a company that invests in and provides consulting to companies that need operational improvement, since September 2014. Previously, Mr. Keddie spent 13 years with HKX, Inc., a developer of control systems for excavators, as a Co-Owner, President & General Manager, from January 1999 to September 2013. Prior to his business leadership roles, Mr. Keddie spent over eight years in both the commercial and military sectors of the aircraft industry. He has been a member of the board of directors of CompuMed since November 2014 and of Stephan Co. (OTC:SPCO), a manufacturer of hair care products, since March 2015. Mr. Keddie was a board member of Essex Rental Corp. (NASDAQ:ESSX), a company that rents and distributes construction lifting equipment, from June 2015 to February 2017. Mr. Keddie is a professional engineer, and received an Honors Co-op Mechanical Engineering Degree from the University of Waterloo, and spent two additional years at the University of Toronto in Aerospace Studies. The Board believes Mr. Keddie's qualifications to serve on the Board include his extensive operating expertise and experience as a director of public companies.

David W. Pointer, age 49, 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 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 48, 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 63, 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 2018 , there were 5 meetings of the Board, 5 meetings of the Audit Committee, 1 meeting of the Compensation Committee and 1 meeting 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 Howard Timothy Eriksen, with Mr. Igdaloff serving as the chairman. The Board has determined that Barry A. Igdaloff and Howard Timothy Eriksen 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 Lee D. Keddie, Howard M. Amster and Barry A. Igdaloff, with Mr. Keddie 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 Barry A. Igdaloff, Howard M. Amster and Lee D. Keddie, with Mr. Igdaloff 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 2018 , 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, 9229 Ward Parkway, Suite 340, Kansas City, MO 64114.

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
9229 Ward Parkway, Suite 340
Kansas City, Missouri 64114
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., 9229 Ward Parkway, Suite 340, Kansas City, MO 64114. 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., 9229 Ward Parkway, Suite 340, Kansas City, MO 64114, 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

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 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 2018, other than as follows: (i) Form 3s of Lee D. Keddie and Howard Timothy Eriksen, each respect to his appointment to the Board on April 12, 2018, which were filed on August 22, 2018, (ii) Form 4s of Howard Timothy Eriksen, Barry Igdaloff, Lee D. Keddie and Howard M. Amster filed on August 22, 2018, each reporting one transaction that occurred on August 17, 2018, and (iii) a Form 4 of Howard M. Amster filed on December 7, 2018, reporting one transaction that occurred on December 4, 2018.

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, 2018 , other than our Chief Executive Officer Mr. Pointer, 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	$ 61,875	$ 25,000	$ 86,875
Howard M. Amster	25,000	$ 25,000	$ 50,000
Howard Timothy Eriksen (2)	18,750	$ 25,000	$ 43,750
Charles M. Gillman (3)	6,250	$ -	$ 6,250
Lee D. Keddie (2)	22,500	$ 25,000	$ 47,500
Robert G. Pearse (3)	8,125	$ -	$ 8,125

(1) Represents the aggregate grant date fair value computed in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 718.
(2) Appointed to the Board in April of 2018.
(3) Resigned from the Board in April of 2018.

On August 15, 2018, the Board approved base compensation for each of the Company's non-employee directors, Barry A. Igdaloff, Howard M. Amster, Howard Timothy Eriksen and Lee D. Keddie, in an amount of $50,000 per annum, including (i) $25,000 in restricted stock awards awarded each year two full business days after the Company files their Quarterly Report on From 10-Q for the second fiscal quarter and 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 August 17, 2018, the Compensation Committee granted to each of the non-employee directors a $25,000 restricted stock award, 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.

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EXECUTIVE COMPENSATION

Our named executive officers during 2018 (each a "Named Executive Officer") were(i) David W. Pointer, our Chief Executive Officer and Chairman of the Board, (ii) Carolyn K. Campbell, our Chief Financial Officer, (iii) Richard M. Rector, President of HCS and (iv) Jeffrey E. Eberwein, our former Executive Chairman..

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 Awards (1)	All Other Compensation	Total
David W. Pointer (2)	2018	$ 72,693	$ 60,000	$ -	$ 66	$ 132,758
Chief Executive Officer and Chairman						
Carolyn K. Campbell (3)	2018	144,904	42,500	-	356	187,760
Chief Financial Officer	2017	43,934	-	15,750	-	59,684
Richard M. Rector (4)	2018	225,000	52,000	-	64,095	341,095
President, Healthcare Staffing, Inc.	2017	101,923	35,000	97,000	6,720	240,643
Jeffrey E. Eberwein (5)	2018	24,658	-	-	-	24,658
Former Executive Chairman	2017	41,369	25,000	75,000	-	141,369

(1) Represents the aggregate grant date fair value computed in accordance with FASB ASC Topic 718.
(2) Mr. Pointer was appointed Chief Executive Officer and Chairman of the Board on March 27, 2018.
(3) Ms. Campbell was appointed Chief Financial Officer on August 14, 2017.
(4) 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 and certain tax waivers per the HCS Purchase Agreement.
(5) Mr. Eberwein resigned from his position as our Executive Chairman effective March 27, 2018.

Outstanding Equity Awards at Fiscal Year-End 2018

The following table sets forth equity incentive plan awards for each of our Named Executive Officers o utstanding as of December 31, 2018 . There were no outstanding stock options for our Named Executive Officers as of December 31, 2018 .

	Stock Awards	
Name	Number of shares or units of stock that have not vested	Market value of shares or unites of stock that have not vested (1)
Richard M. Rector (2)	600,000	$ 12,000

(1) Based on the closing share price on December 31, 2018 of $0.02.
(2) Shares of restricted stock granted under the 2015 Incentive Stock Plan. 350,000 of these shares vest on July 27, 2019 and 250,000 of these shares vest on July 27, 2020, subject to continuous employment with HCS through each applicable vesting date.

Employment Agreements and Arrangements with Named Executive Officers

David W. Pointer

Mr. Pointer entered an employment agreement with the Company on March 27, 2018 (the "Pointer Employment Agreement"). Mr. Pointer's base salary is $100,000, and he is eligible to earn an annual bonus, based on performance benchmarks, and to participate in any equity programs of the Company, at the Company's discretion. The Pointer Employment Agreement has an indefinite term and provided that Mr. Pointer 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. Pointer's employment is terminated by the Company other than for "cause" or by Mr. Pointer for "good reason" (each as defined in the Pointer Employment Agreement), Mr. Pointer will receive, over a period of 12 months following termination, compensation at an annual rate equal to his then-existing annual base salary.

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. On March 22, 2019, Richard M. Rector, President of HCS., provided notice to the Company of his resignation from his position with HCS, effective 30 days after the date of such notice.

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.

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

The following table sets forth sets forth certain information with respect to beneficial ownership of the Company's common stock as of March 28, 2019 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., 9229 Ward Parkway, Suite 340, Kansas City, MO 64114.

	Beneficial Ownership of Common Stock	
Name of Beneficial Owner	**Shares**	**Percent of Class (1)**
Directors and Named Executive Officers		
Howard M. Amster (2)	3,062,735	3.0%
Howard Timothy Eriksen (3)	833,333	*
Barry A. Igdaloff (4)	9,594,488	9.4%
Lee D. Keddie (5)	833,333	*
Carolyn K. Campbell (6)	400,000	*
David W. Pointer (7)	2,000,000	2.0%
Richard M. Rector (8)	1,000,000	1.0%
Jeffrey E. Eberwein (9)	1,282,368	1.3%
All current directors and executive officers as a group (7 persons) (10)	17,723,889	17.4%
5% Beneficial Owners		
Massachusetts Mutual Life Insurance Company (11)	19,258,775	19.0%

* Less than 1%

(1) Based on 101,577,893 shares of common stock outstanding as of March 25, 2019 . 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 2,193,234 shares of common stock, 833,333 shares of unvested restricted stock and 36,168 shares of common stock issuable upon exercise of options held directly.

(3) Consists of 833,333 shares of unvested restricted stock.

(4) Consists of 5,267,973 shares of common stock, 833,333 shares of unvested restricted stock and 36,168 shares of common stock issuable upon exercise of options held directly; and 3,457,014 shares of common stock controlled by Mr. Igdaloff as a registered investment advisor.

(5) Consists of 833,333 shares of unvested restricted stock.

(6) Consists of 150,000 shares of common stock and 250,000 shares of unvested restricted stock.

(7) Consists of 2,000,000 shares of unvested restricted stock.

(8) Consists of 400,000 shares of common stock and 600,000 shares of unvested restricted stock

(9) Consists of 1,277,155 shares of common stock held directly and 5,212 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 8,011,207 shares of common stock; 6,183,332 shares of unvested restricted stock; and 72,336 shares of common stock issuable upon exercise of options. Excludes shares beneficially owned by Mr. Eberwein who is no longer an executive officer or director 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, 2018 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	72,336	$ 1.17	6,152,088

(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 Years Ended December 31,	
	2018	2017
Audit fees (1)	$ 118,449	$ 144,977
Tax	60,249	35,883
Other (2)	-	20,311
Total	$ 178,697	$ 201,171

(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 (2017 only).
(2) 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 2018 and 2017 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.

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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 Exhibit Index below.

Item 16. Form 10-K Summary

None.

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	Articles of Amendment to Articles of Amendment and Restatement (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed on December 14, 2018).
3.3	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).
4.5	Third Amendment to Rights Agreement, dated as of July 20, 2018, between Novation Companies, Inc. and Computershare Trust Company, N.A. (incorporated by reference to Exhibit 4.1 on the Current Report on Form 8-K filed on July 25, 2018).
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 (incorporated by reference to Exhibit 10.11 to the Annual Report on Form 10-K filed on April 10, 2018).*
10.12	Employment Agreement, dated as of July 27, 2017, by and among Healthcare Staffing, Inc., Novation Companies, Inc. and Richard Rector (incorporated by reference to the Annual Report on Form 10-K filed on April 10, 2018).*
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, 2018, formatted in XBRL (Extensible Business Reporting Language) includes: (i) Consolidated Balance Sheets as of December 31, 2018 and December 31, 2017, (ii) Consolidated Statements of Operations for the years ended December 31, 2018 and 2017, (iii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2018 and 2017, (iv) Consolidated Statements of Shareholders' Deficit for the years ended December 31, 2018 and 2017, (v) Consolidated Statements of Cash Flows for the years ended December 31, 2018 and 2017, 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: March 28, 2019	/s/ DAVID W. POINTER David W. Pointer, Chief Executive Officer and Chairman
DATE: March 28, 2019	/s/ CAROLYN K. CAMPBELL Carolyn K. Campbell, Chief Financial Officer

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: March 28, 2019	/s/ DAVID W. POINTER David W. Pointer, Chief Executive Officer and Chairman (Principal Executive Officer)
DATE: March 28, 2019	/s/ CAROLYN K. CAMPBELL Carolyn K. Campbell, Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)
DATE: March 28, 2019	/s/ HOWARD M. AMSTER Howard M. Amster, Director
DATE: March 28, 2019	/s/ HOWARD TIMOTHY ERIKSEN Howard T. Eriksen, Director
DATE: March 28, 2019	/s/ BARRY A. IGDALOFF Barry A. Igdaloff, Director
DATE: March 28, 2019	/s/ LEE D. KEDDIE Lee D. Keddie, Director

Exhibit 21.1

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

Exhibit 23.1

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 March 28, 2019 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, 2018 .

/s/ BOULAY PLLP

Minneapolis, MN
March 28, 2019

Exhibit 31.1

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: March 28, 2019

/s/ David W. Pointer
David W. Pointer
Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

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: March 28, 2019

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

Exhibit 32.1

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, 2018 , 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: March 28, 2019

/s/ David W. Pointer
David W. Pointer
Chief Executive Officer
(Principal Executive Officer)

Exhibit 32.2

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, 2018 , 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: March 28, 2019

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