NOVATION COMPANIES, INC.
Form 10-Q
November 06, 2014

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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2014

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

For the Transition Period From to

Commission File Number 001-13533

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

Maryland (State or Other Jurisdiction of Incorporation or Organization)	74-2830661 (I.R.S. Employer Identification No.)
2114 Central Street, Suite 600, Kansas City, MO (Address of Principal Executive Office)	64108 (Zip Code)

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

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

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

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

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

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

The number of shares of the Registrant's Common Stock outstanding on October 31, 2014 was 91,479,519.

NOVATION COMPANIES, INC.
FORM 10-Q
For the Quarterly Period Ended September 30, 2014

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
NOVATION COMPANIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited; dollars in thousands, except share and per share amounts)

	September 30, 2014	December 31, 2013
Assets		
Current Assets		
Cash and cash equivalents	$16,495	$5,768
Marketable securities, current	31,014	3,728
Service fee receivable, net of allowance of $72 and $14, respectively	976	424
Other current assets	1,788	1,648
Current assets of discontinued operations	900	11,069
Total current assets	51,173	22,637
Non-Current Assets		
Marketable securities, non-current	8,576	—
Property and equipment, net of accumulated depreciation	4,993	3,596
Deferred income tax asset, net	968	1,101
Other assets	1,391	760
Non-current assets of discontinued operations	—	5,948
Total non-current assets	15,928	11,405
Total assets	$67,101	$34,042
Liabilities and Shareholders' Equity (Deficit)		
Liabilities:		
Current Liabilities		
Accounts payable and accrued expenses	$3,815	$2,391
Deferred income tax liability, net	968	1,101
Other current liabilities	573	1,561
Current liabilities of discontinued operations	1,837	8,312
Total current liabilities	7,193	13,365
Non-Current Liabilities		
Senior notes	85,518	83,867
Other liabilities	762	3,666
Non-current liabilities of discontinued operations	1,721	1,364
Total non-current liabilities	88,001	88,897
Total liabilities	95,194	102,262
Commitments and contingencies (Note 8)		
Shareholders' deficit:		
Capital stock, $0.01 par value per share, 120,000,000 shares authorized:		
Common stock, 91,479,519 shares issued and outstanding	915	915
Additional paid-in capital	743,893	739,468
Accumulated deficit	(775,617)	(811,742)
Accumulated other comprehensive income	2,716	3,103
Total Novation Companies, Inc. shareholders' deficit	(28,093)	(68,256)
Noncontrolling interests	—	36
Total shareholders' deficit	(28,093)	(68,220)

Total liabilities and shareholders' deficit	$67,101	$34,042

See notes to condensed consolidated financial statements.

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NOVATION COMPANIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited; dollars in thousands, except share and per share amounts)

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2014	2013	2014	2013
Income and Revenues:				
Service fee income	$4,066	$731	$1,679	$452
Interest income – mortgage securities	5,382	3,767	1,986	1,362
Total	9,448	4,498	3,665	1,814
Costs and Expenses:				
Cost of services	4,276	754	2,141	302
Selling, general and administrative expense	16,811	14,547	5,848	4,856
Total	21,087	15,301	7,989	5,158
Other income (expense)	102	912	36	(418)
Interest expense	(2,358)	(2,390)	(764)	(807)
Loss from continuing operations before income taxes	(13,895)	(12,281)	(5,052)	(4,569)
Income tax (benefit) expense, continuing operations	(8,606)	27,289	(1,376)	(377)
Net loss from continuing operations	(5,289)	(39,570)	(3,676)	(4,192)
Income (loss) from discontinued operations, net of income taxes	41,414	11,379	(1,206)	1,915
Net income (loss)	36,125	(28,191)	(4,882)	(2,277)
Less: Net loss attributable to noncontrolling interests	—	(165)	—	(88)
Net income (loss) attributable to Novation	$36,125	$(28,026)	$(4,882)	$(2,189)
Earnings Per Share attributable to Novation:				
Basic	$0.40	$(0.31)	$(0.05)	$(0.02)
Diluted	$0.40	$(0.31)	$(0.05)	$(0.02)
Weighted average basic shares outstanding	90,895,504	90,745,504	90,951,716	90,801,716
Weighted average diluted shares outstanding	90,895,504	90,745,504	90,951,716	90,801,716

See notes to condensed consolidated financial statements.

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NOVATION COMPANIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited; dollars in thousands)

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2014	2013	2014	2013
Net income (loss)	$36,125	$(28,191)	$(4,882)	$(2,277)
Other comprehensive income (loss):				
Change in unrealized gain on marketable securities – available-for-sale (Note 9)	(387)	(415)	(211)	58
Total comprehensive income (loss)	35,738	(28,606)	(5,093)	(2,219)
Comprehensive loss attributable to noncontrolling interests:				
Less: Net loss attributable to noncontrolling interests	—	(165)	—	(88)
Total comprehensive income (loss) attributable to Novation	$35,738	$(28,441)	$(5,093)	$(2,131)

See notes to condensed consolidated financial statements.

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NOVATION COMPANIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT)
(unaudited; dollars in thousands)

	Total Novation Shareholders' Equity (Deficit)					
	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Noncontrolling Interests	Total Shareholders' Equity (Deficit)
Balance, December 31, 2013	$915	$739,468	$ (811,742)	$ 3,103	$ 36	$ (68,220)
Compensation recognized under stock compensation plans	—	611	—	—	—	611
Distributions to noncontrolling interests	—	—	—	—	(5)	(5)
Exchange of membership interests for forgiveness of note payable	—	3,814	—	—	107	3,921
Deconsolidation of subsidiary	—	—	—	—	(138)	(138)
Net income	—	—	36,125	—	—	36,125
Other comprehensive loss	—	—	—	(387)	—	(387)
Balance, September 30, 2014	$915	$743,893	$ (775,617)	$ 2,716	$ —	$ (28,093)

	Total Novation Shareholders' Equity (Deficit)					
	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Noncontrolling Interests	Total Shareholders' Equity (Deficit)
Balance, December 31, 2012	$915	$740,171	$ (744,213)	$ 3,301	$ (2,198)	$ (2,024)
Compensation recognized under stock compensation plans	—	363	—	—	—	363
Contributions from noncontrolling interests	—	—	—	—	158	158
Distributions to noncontrolling interests	—	—	—	—	(651)	(651)
Acquisition of noncontrolling interests	—	(1,863)	—	—	1,863	—
Adjustment to estimated accrued offering costs	—	1,770	—	—	—	1,770
Net loss	—	—	(28,026)	—	(165)	(28,191)
Other comprehensive loss	—	—	—	(415)	—	(415)
Balance, September 30, 2013	$915	$740,441	$ (772,239)	$ 2,886	$ (993)	$ (28,990)

See notes to condensed consolidated financial statements.

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NOVATION COMPANIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited; dollars in thousands)

	For the Nine Months Ended September 30, 2014	2013
Cash flows from operating activities:		
Net income (loss)	$36,125	$(28,191)
Net income from discontinued operations	41,414	11,379
Net loss from continuing operations	(5,289)	(39,570)
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Accretion of mortgage securities	(478)	(580)
Provision for (recovery of) bad debt, net	76	(1,051)
Amortization of deferred debt issuance costs and senior debentures discount	1,651	1,592
Fair value adjustments	—	(150)
Loss on disposal of fixed assets	15	443
Compensation recognized under stock compensation plans	611	363
Depreciation expense	1,130	677
Deferred taxes	(8,605)	27,600
Eliminations of intercompany activity	3,057	6,909
Changes in:		
Due from discontinued operations	5,703	(885)
Service fee receivable	(628)	(144)
Other current assets and liabilities, net	(180)	219
Other noncurrent assets and liabilities, net	(32)	(441)
Deferred revenue	(3)	17
Accounts payable and accrued expenses	(328)	451
Net cash used in operating activities of continuing operations	(3,300)	(4,550)
Net cash (used in) provided by operating activities of discontinued operations	(5,005)	7,420
Net cash (used in) provided by operating activities	(8,305)	2,870
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	3,484	552
Proceeds from paydowns of notes receivable	—	1,721
Issuance of notes receivable	—	(258)
Proceeds from sale of subsidiary	54,748	—
Purchases of available-for-sale securities	(39,256)	—
Purchase of cost method investment	(600)	—
Purchases of property and equipment	(2,411)	(1,938)
Net cash provided by investing activities of continuing operations	15,965	77
Net cash provided by (used in) investing activities of discontinued operations	455	(355)
Net cash provided by (used in) investing activities	16,420	(278)
Cash flows from financing activities:		
Cash payments for contributions of capital to discontinued operations	(2,510)	(992)
Cash receipts from distributions of earnings from discontinued operations	774	6,864
Principal payments under capital leases	(202)	(159)

Paydowns of note payable to related party	—	(750)
Net cash (used in) provided by financing activities of continuing operations	(1,938)	4,963
Net cash provided by (used in) financing activities of discontinued operations	1,659	(6,475)
Net cash used in financing activities	(279)	(1,512)

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NOVATION COMPANIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited; dollars in thousands)

	For the Nine Months Ended September 30,	
	2014	2013
Net increase in cash and cash equivalents of continuing operations	$10,727	$490
Cash and cash equivalents, beginning of period	5,768	8,813
Cash and cash equivalents, end of period	$16,495	$9,303
Net (decrease) increase in cash and cash equivalents of discontinued operations	$(2,891)	$590
Cash and cash equivalents, beginning of period	3,499	7,549
Cash and cash equivalents, end of period	$608	$8,139

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION
(unaudited; dollars in thousands)

	For the Nine Months Ended September 30,	
	2014	2013
Cash paid for interest	$776	$813
Cash received from income taxes, net	39	21
Cash received on mortgage securities – available-for-sale with no cost basis	4,813	3,187
Non-cash investing and financing activities:		
Exchange of membership interests for forgiveness of note payable	3,921	—
Acquisition of noncontrolling interest for extinguishment of intercompany debt	—	1,863
Adjustment to estimated accrued offering costs	—	1,770
Assets acquired under capital lease	167	314

See notes to condensed consolidated financial statements.

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NOVATION COMPANIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
As of and for the period ended September 30, 2014 (Unaudited)

Note 1. Financial Statement Presentation

Description of Operations – Novation Companies, Inc. (the “Company” or "Novation" or "we” or “us”) acquires and operates technology-enabled service businesses, with a focus on building and developing these businesses to create long-term value.

The Company owns 100% of CorvisaCloud, LLC ("CorvisaCloud"). CorvisaCloud provides cloud-based communication software under the CorvisaOne™ brand and implementation consulting services for its own clients as well as clients of a leading customer relationship management (CRM) software provider.

On August 18, 2014, the Company announced that it would be conducting an orderly winding-down of the remaining business and operations of Advent Financial Services LLC (“Advent”) a financial settlement services provider for professional tax preparers nationwide. As discussed in Note 3, the operations of Advent have been classified as discontinued operations for all periods presented.

On April 16, 2014, the Company and the non-controlling members of StreetLinks, a national residential appraisal and mortgage real estate valuation management services company, entered into a purchase and sale agreement with Assurant Services, LLC, a subsidiary of Assurant, Inc. ("Assurant"), pursuant to which Assurant purchased 100% of the outstanding membership units of StreetLinks. This transaction closed on April 16, 2014. See Note 3 to the condensed consolidated financial statements for additional information regarding this transaction. The operations of StreetLinks have been classified as discontinued operations for all periods presented.

Effective February 27, 2013 the Company and non-controlling owners agreed to dissolve Mango Moving, LLC ("Mango"), a third-party logistics provider within the household goods industry, and abandon its operations. As discussed in Note 3, the operations of Mango have been classified as discontinued operations for all periods presented.

Financial Statement Presentation – The Company’s condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the 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 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 condensed consolidated financial statements and footnotes reflect the best estimates and judgments of management at the time, actual results could differ significantly from those estimates.

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 condensed consolidated financial statements of the Company include the accounts of all wholly-owned and majority-owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

The Company's condensed consolidated financial statements are unaudited. In the opinion of management, all necessary adjustments have been made, which were of a normal and recurring nature, for a fair presentation of the condensed consolidated financial statements. The Company's condensed consolidated financial statements should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements of the Company and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

Note 2. New Accounting Pronouncements

In August 2014, the FASB issued Accounting Standards Updated ("ASU") 2014-15, Presentation of Financial Statements-Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern, which provides guidance on determining when and how reporting entities must disclose going-concern uncertainties in their financial statements. The new standard requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date of issuance of the entity’s financial statements (or within one year after the date on which the financial statements are available to be issued, when applicable). Further, an entity must provide certain disclosures if there is “substantial doubt about the entity’s ability to continue as a going concern.” This ASU is effective for annual periods ending after December 15, 2016, and interim periods thereafter. Early adoption is permitted. The Company does not expect this guidance to have a significant impact on the Company’s financial statements.

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In May 2014, the FASB issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The ASU applies to all contracts with customers except those that are within the scope of other topics in the FASB Accounting Standards Codification. Compared with current U.S. GAAP, the ASU also requires significantly expanded disclosures about revenue recognition. The ASU is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016. Early application is not permitted. The Company is evaluating the impact of ASU 2014-09 on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

In April 2014, the FASB issued ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which amends the definition of a discontinued operation in ASC 205-20 and requires entities to provide additional disclosures about discontinued operations as well as disposal transactions that do not meet the discontinued-operations criteria. The FASB issued the ASU to provide more decision-useful information and to make it more difficult for a disposal transaction to qualify as a discontinued operation. The ASU is effective prospectively for all disposals (except disposals classified as held for sale before the adoption date) or components initially classified as held for sale in periods beginning on or after December 15, 2014. Early adoption is permitted. The impact of the adoption of ASU 2014-08 on the Company's financial statements will be based on future disposal activity.

In September 2013, the U.S. Department of the Treasury and the IRS released final regulations providing guidance on the application of IRC Section 263(a) to amounts paid to acquire, produce, or improve tangible property, as well as rules for materials and supplies (“Tangible Property Regulations”). While the Tangible Property Regulations are generally effective for taxable years beginning on or after January 1, 2014, taxpayers are permitted to early adopt provisions for years beginning on or after January 1, 2012. This guidance did not have a significant impact on the Company's financial statements.

In July 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force), which provides guidance on financial statement presentation of an unrecognized tax benefit when a net operating loss (NOL) carryforward, a similar tax loss, or a tax credit carryforward exists. The FASB's objective in issuing this ASU is to eliminate diversity in practice resulting from a lack of guidance on this topic in current U.S. GAAP. This ASU applies to all entities with unrecognized tax benefits that also have tax loss or tax credit carryforwards in the same tax jurisdiction as of the reporting date and is effective for fiscal years beginning after December 15, 2013, and interim periods within those years. This guidance did not have a significant impact on the Company's financial statements.

Note 3. Divestitures

Advent Financial Services, LLC (Financial Intermediary Segment)

On August 18, 2014, Advent sold certain intellectual property, software, and customer data to Santa Barbara Tax Products Group, LLC, for cash consideration of $1.0 million paid at closing. The transaction resulted in a gain of approximately $0.8 million, which is included in net income from discontinued operations on the condensed consolidated statement of operations.

Also on August 18, 2014, the Company announced that it was conducting an orderly winding-down of Advent's remaining business and operations. As the run-off operations were substantially complete as of September 30, 2014, and as the Company will not have any significant continuing involvement in Advent, the operations of Advent have been classified as discontinued operations for all periods presented.

StreetLinks, LLC (Appraisal Management Segment)

On April 16, 2014, the Company and non-controlling members of StreetLinks (the "Sellers") entered into a purchase and sale agreement with Assurant, pursuant to which Assurant purchased 100% of the outstanding membership units of StreetLinks in exchange for $60.0 million paid in cash at closing and up to $12.0 million in post-closing consideration contingent upon the total revenue of StreetLinks in fiscal years 2015 and 2016. The sale closed on April 16, 2014. The Company received approximately $53.9 million in cash proceeds at closing, of which $1.0 million was used to make certain earned bonus payments to three StreetLinks executives. Subsequent to closing, the Company received an additional $0.8 million relating to adjustments for working capital.

The post-closing consideration provides for payment if (a) the total revenue of StreetLinks is $184 million or more for calendar year 2015, Assurant shall pay to the Sellers an aggregate of $12.0 million; but if not, then (b) if the total revenue of StreetLinks is greater than $167.5 million for the calendar year 2016, Assurant shall pay to Sellers up to an aggregate of $12.0 million, based on a linear scale where full payment of the $12.0 million would occur at total revenue of $184 million. The post-closing consideration will be reduced for certain earned bonus payments to three StreetLinks executives of $2.0 million if the maximum post-closing consideration is earned and otherwise prorated based on the same linear scale.

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The transaction resulted in a gain of approximately $48.2 million, which is included in the net income from discontinued operations line on the condensed consolidated statement of operations. Also included in net income from discontinued operations are approximately $1.8 million of transaction-related expenses, such as legal and consulting fees.

In connection with the sale, the Company and Assurant also entered into a transition services agreement, pursuant to which the Company will provide ongoing information technology, human resources management and accounting services to StreetLinks for a period of up to eighteen months. The cash flows related to these services are not significant to StreetLinks. The Company will have no significant continuing involvement with StreetLinks beyond the transition services. Professional service fees earned by the ongoing entity under the transition services agreement are included in service fee income on the condensed consolidated statement of operations.
The Company has also executed a Non-Competition, Non-Solicitation and Non-Disclosure Agreement with StreetLinks providing that Novation will be prohibited from competing in the real estate appraisal management or valuation services business for a period of four years.
Mango Moving LLC (Logistics Segment)

Because of continued capital demands and difficulties generating positive cash flows or earnings, effective February 27, 2013, the Company committed to a plan to abandon the operations of Mango, which comprised the Company's entire Logistics segment. The run-off operations of Mango ceased during the first quarter of 2013, and the Company will not have any significant continuing involvement in Mango.

Results of Discontinued Operations

For the nine and three months ended September 30, 2014, net income from discontinued operations consists of the net operating income and losses of the disposed entities and any necessary eliminations through the date of sale or disposal, the gain on the sale of StreetLinks and any transaction-related expenses, income tax expense, and the gain on the sale of Advent intellectual property. For the nine and three months ended September 30, 2013, net income (loss) from discontinued operations consists solely of the net operating income and losses of the disposed entities and any necessary eliminations.

The results of the Company's discontinued operations are summarized below:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2014	2013	2014	2013
Service fee income	$37,840	$125,332	$493	$32,555
Income (loss) from discontinued operations before income taxes	$50,057	$11,379	$(390)	$1,915
Income tax expense	8,643	—	816	—
Income (loss) from discontinued operations, net of income taxes	$41,414	$11,379	$(1,206)	$1,915

The assets and liabilities of discontinued operations as of September 30, 2014 relate entirely to Advent. As of September 30, 2014, the current liabilities of discontinued operations were comprised primarily of accruals for rebate and incentive programs, unclaimed funds, and electronic return originator (ERO) fees held for various violations of Advent's compliance program. The Company anticipates that the majority of the accruals for rebates and incentives will be settled within the next twelve months, while unclaimed funds will be escheated to the applicable state in accordance with unclaimed property laws. Obligations relating to ERO fees that have been held will be resolved when claims are received or when the statute of limitations for the related contractual obligation expires.

Noncurrent liabilities of discontinued operations consist entirely of ERO fees held for various violations of Advent's compliance program. The classification of ERO fees held as current versus noncurrent is dependent on the nature of the compliance violation and the tax year during which the violation occurred.

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The major classes of assets and liabilities of discontinued operations as of September 30, 2014 and December 31, 2013 are detailed below.

	September 30, 2014	December 31, 2013
Assets		
Current Assets		
Cash and cash equivalents	$608	$3,499
Service fee receivable, net	—	4,850
Other current assets	292	2,720
Total current assets	900	11,069
Non-Current Assets		
Property and equipment, net of accumulated depreciation	—	1,329
Goodwill	—	3,170
Other assets	—	1,449
Total non-current assets	—	5,948
Total assets	$900	$17,017
Liabilities		
Current Liabilities		
Accounts payable and accrued expenses	$1,837	$7,468
Other current liabilities	—	844
Total current liabilities (A)	1,837	8,312
Non-Current Liabilities		
Other liabilities	1,721	1,364
Total non-current liabilities	1,721	1,364
Total liabilities (A)	$3,558	$9,676

(A) Excludes amounts due to Novation of approximately $0.7 million and $6.4 million as of September 30, 2014 and December 31, 2013, respectively. These amounts are eliminated upon consolidation and, therefore, are not included in the consolidated balance sheets for any periods presented.

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Note 4. Marketable Securities

The following table presents certain information on the Company's portfolio of available-for-sale securities as of September 30, 2014 and December 31, 2013 (dollars in thousands):

	As of September 30, 2014			
Description of Securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Marketable securities, current				
Corporate notes and bonds	$22,239	$—	$(12)	$22,227
Agency securities	3,130	—	—	3,130
Commercial paper	1,997	—	(1)	1,996
Certificates of deposit	200	—	—	200
Mortgage securities	709	2,752	—	3,461
Total	$28,275	$2,752	$(13)	$31,014
Marketable securities, non-current				
Corporate notes and bonds	$8,598	$—	$(22)	$8,576

	As of December 31, 2013			
Description of Securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Marketable securities, current				
Mortgage securities	$625	$3,103	$—	$3,728

Prior to 2008, the Company originated, purchased, securitized, sold, invested in and serviced residential nonconforming mortgage loans and mortgage securities. As a result of those activities, we acquired mortgage securities that continue to be a source of our earnings and cash flow. As of September 30, 2014 and December 31, 2013, 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, prepayment penalty and overcollateralization bonds.

There were no other-than-temporary impairments relating to available-for-sale securities for the nine and three months ended September 30, 2014 and 2013. The average remaining maturities of the Company’s short-term and long-term available-for-sale investments at September 30, 2014 were approximately five months and eighteen months, respectively. Maturities of mortgage securities owned by the Company depend on repayment characteristics and experience of the underlying financial instruments. See Note 9 to the condensed consolidated financial statements for details on the Company's fair value methodology.

Variable Interest Entities

The following table relates to the securitizations where the Company retained an interest in the assets issued by the securitization trust, a variable interest entity or VIE (dollars in thousands):

	Size/Principal Outstanding (A)	Assets on Balance Sheet (B)	Liabilities on Balance Sheet	Maximum Exposure to Loss(C)	Year to Date Loss on Sale	Year to Date Cash Flows (D)
September 30, 2014	$4,179,355	$3,461	$—	$3,461	$—	$5,298
December 31, 2013	4,811,987	3,728	—	3,728	—	3,739

(A) Size/principal outstanding reflects the estimated principal of the underlying assets held by the VIE.
(B) Assets on balance sheet are securities issued by the entity and are recorded in the mortgage securities line item on the condensed consolidated balance sheets.
(C) The maximum exposure to loss includes the assets held by the Company and assumes a total loss on the referenced assets held by the VIE.
(D) Year to date cash flows are for the nine months ended September 30, 2014 and 2013, respectively.

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Note 5. Business Combinations and Consolidation

Prior to 2013, the Company entered into a Membership Interest Purchase Agreement (the "Unit Purchase Agreement") with its Chief Operating Officer, Mr. Steve Haslam, pursuant to which Mr. Haslam sold 1,927 units in StreetLinks to the Company in exchange for a total purchase price of $6.1 million, payable in quarterly installments. At the time of the original transaction, Mr. Haslam's units represented approximately 5% of the outstanding StreetLinks membership units. On April 16, 2014, the Company and Mr. Haslam agreed to terminate the Unit Purchase Agreement. In full satisfaction of the Company's outstanding obligations under the Unit Purchase Agreement, which are discussed further in Note 7 to the condensed consolidated financial statements, the Company transferred back to Mr. Haslam 1,218 StreetLinks membership units (approximately 3% of StreetLinks), which represents the portion of the membership units attributable to the $3.9 million in unpaid installment payments and $0.2 million in interest remaining under the Unit Purchase Agreement. The termination of the Unit Purchase Agreement and simultaneous transfer of 1,218 StreetLinks membership units to Mr. Haslam reduced the Company's ownership interest to approximately 88% as of April 16, 2014.

During the fourth quarter of 2013, the Company, through a series of transactions with the minority owners of CorvisaCloud, acquired an additional 15% ownership stake in CorvisaCloud for a total purchase price of approximately $0.6 million. These transactions increased the Company's ownership interest in CorvisaCloud to 100% as of December 31, 2013.

Prior to 2013, Advent entered into a revolving note and revolving credit agreement with the Company whereby the noncontrolling members of Advent pledged their membership interests as security for Advent's obligations under the agreements. As a result of Advent's default under the agreements, during the second quarter of 2013 the Company foreclosed on the membership interests of the noncontrolling members in full satisfaction of Advent's outstanding intercompany debt obligations. At the time of foreclosure, Advent's noncontrolling members held approximately 22% of the outstanding membership interests. Therefore, the foreclosure raised the Company's ownership interest in Advent to 100% as of December 31, 2013. In accordance with the relevant accounting guidance, this debt extinguishment was treated as an equity transaction, reducing both additional paid in capital and Advent's noncontrolling interest deficit by approximately $1.9 million on a consolidated basis with no corresponding gain or loss recognized in the condensed consolidated statement of operations.

Note 6. Property and Equipment, Net

All of the Company's property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the related assets. The estimated useful lives of the Company's property and equipment are the lesser of 5 years or remaining lease term for leasehold improvements, 5 years for furniture and fixtures, 3 to 5 years for office and computer equipment, and 3 years for software.

Maintenance and repairs are charged to expense. Major renewals and improvements are capitalized. Gains and losses on dispositions are credited or charged to earnings as incurred. Depreciation and amortization expense relating to property and equipment was $1.1 million and $0.4 million for the nine and three months ended September 30, 2014, respectively and $0.7 million and $0.3 million for the nine and three months ended September 30, 2013, respectively.

The following table shows the Company's property and equipment, net as of September 30, 2014 and December 31, 2013 (dollars in thousands):

	September 30, 2014	December 31, 2013

Furniture, fixtures and office equipment	$755	$509
Hardware and computer equipment	3,123	2,382
Software	3,570	2,309
Leasehold improvements	894	727
Total Cost	8,342	5,927
Less: Accumulated depreciation and amortization	(3,349)	(2,331)
Property and equipment, net	$4,993	$3,596

The hardware and computer equipment amount above includes gross assets under capital leases of $0.9 million and $0.7 million as of September 30, 2014 and December 31, 2013, respectively. Accumulated depreciation and amortization relating to these assets totaled approximately $0.4 million and $0.3 million as of September 30, 2014 and December 31, 2013, respectively.

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Note 7. Borrowings

Senior Notes – The Company has outstanding unsecured senior notes pursuant to three indentures (collectively, the "Senior Notes") with an aggregate principal balance of $85.9 million. The Senior Notes were created through an exchange of the Company's previously outstanding junior subordinated notes that occurred prior to 2012. This exchange was considered a modification of a debt instrument for accounting purposes, therefore the Company uses the effective interest method to accrete from the existing balances of $85.5 million and $83.9 million as of September 30, 2014 and December 31, 2013, respectively to the aggregate principal balance of $85.9 million.

The Senior Notes accrue interest at a rate of 1.0% until the earlier of (a) the completion of an equity offering by the Company or its subsidiaries that results in proceeds of $40 million or more or (b) January 1, 2016. Thereafter, the Senior Notes will accrue interest at a rate of three-month LIBOR plus 3.5% (the "Full Rate"). Interest on the Senior Notes is paid on a quarterly basis and no principal payments are due until maturity on March 30, 2033.

The indentures governing the Senior Notes (the "Indentures") contain certain restrictive covenants (the "Negative Covenants") subject to certain exceptions in the Indentures, including written consent of the holders of the Senior Notes. The Negative Covenants prohibit the Company and its subsidiaries, from among other things, incurring debt, permitting any lien upon any of its property or assets, making any cash dividend or distribution or liquidation payment, acquiring shares of the Company or its subsidiaries, making payment on debt securities of the Company that rank pari passu or junior to the Senior Notes, or disposing of any equity interest in its subsidiaries or all or substantially all of the assets of its subsidiaries. The Negative Covenants remain in effect until both of the following conditions are met: 1) the Senior Notes begin accruing interest at the Full Rate, and 2) the Company satisfies certain financial covenants (the "Financial Covenants"). Satisfaction of the Financial Covenants requires the Company to demonstrate on a consolidated basis that (1) its Tangible Net Worth is equal to or greater than $40 million, and (2) either (a) the Interest Coverage Ratio is equal to or greater than 1.35x, or (b) the Leverage Ratio is not greater than 95%. As the Senior Notes were not accruing interest at the Full Rate, the Negative Covenants, as defined above, were still in effect as of September 30, 2014 and December 31, 2013. Compliance with the Financial Covenants is required only when the Company seeks to take action prohibited by the Negative Covenants that has not been approved by the holders of the Senior Notes.

As discussed in Note 3, the Company and the non-controlling members of StreetLinks entered into a purchase and sale agreement with Assurant, pursuant to which Assurant purchased 100% of the outstanding membership units of StreetLinks. The sale of a subsidiary is not prohibited by the Negative Covenants provided that the sale is at fair market value and the proceeds are reinvested in the Company. As such, the Company was in compliance with all Negative Covenants as of September 30, 2014 and December 31, 2013, and therefore the Company was under no obligation to comply with the Financial Covenants during these periods.

Note Payable to Related Party – As detailed in Note 5, on April 16, 2014, the Company and Mr. Haslam agreed to terminate the Unit Purchase Agreement. In full satisfaction of the Company's outstanding obligation under the Unit Purchase Agreement, the Company transferred back to Mr. Haslam 1,218 StreetLinks membership units, which represents the portion of the membership units attributable to the $3.9 million in unpaid installment payments and $0.2 million in interest remaining under the Unit Purchase Agreement.

As of December 31, 2013, current maturities of the note payable to Mr. Haslam under the Unit Purchase Agreement of approximately $1.3 million and noncurrent maturities of $2.6 million are included in the other current liabilities and other liabilities line items, respectively, in the Company's condensed consolidated balance sheets.

Capital Leases – The Company leases hardware and computer equipment under capital leases. These capital leases are payable in 36 monthly installments and mature between July 2015 and July 2017. Current maturities of obligations under capital leases were approximately $0.3 million and $0.2 million as of September 30, 2014 and December 31, 2013, respectively. Noncurrent maturities of obligations under capital leases were approximately $0.2 million as of both September 30, 2014 and December 31, 2013, respectively. Due to the immaterial nature of these obligations with regard to the Company's financial statements as a whole, current maturities and noncurrent maturities of capital leases are included in the other current liabilities and other liabilities line items, respectively, in the Company's condensed consolidated balance sheets.

Note 8. Commitments and Contingencies

Commitments – In September 2014, Steve Haslam, Senior Vice President and Chief Operating Officer of the Company announced that, in lieu of accepting a new role with the Company and relocating, he was retiring from the Company effective October 1, 2014. Pursuant to the terms of his Employment Agreement dated March 8, 2012, Mr. Haslam elected to terminate his employment for “Good Reason” in connection with the new position and relocation offered to him. In addition to accrued but unpaid salary and other benefits, Mr. Haslam will be paid $0.4 million severance over the next twelve months. The full amount of Mr. Haslam's severance was charged to income from continuing operations during the three months ended September 30, 2014 in accordance with the relevant accounting guidance. The corresponding accrual is included in accounts payable and accrued expenses and will be reduced as payments are made to Mr. Haslam.

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In conjunction with its minority investment in ManyWho, Inc. ("ManyWho") during the second quarter of 2014, CorvisaCloud entered into an Original Equipment Manufacturer ("OEM") agreement with ManyWho, which provides CorvisaCloud with a non-exclusive license to integrate ManyWho's workflow technology into existing and forthcoming CorvisaCloud service offerings. In exchange for this non-exclusive license, the OEM agreement provides for a usage-based royalty as well as certain guaranteed minimum annual royalty and professional services fees. The annual minimums due under the agreement are set forth in the table below.

	Minimum Royalties
2015	$500
2016	500
2017	750
	$1,750

As of September 30, 2014, the Company has accrued approximately $0.1 million under the OEM agreement. This accrual is included in accounts payable and accrued expenses, with the corresponding expense included in cost of services for the nine and three months ended September 30, 2014.

Contingencies – Prior to 2008, 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”) made in loan sale and securitization documents. These demands have been received substantially beginning in 2006 and have continued into 2014. 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 a loan due to missing documentation or breaches of representations or warranties made in sale documents that materially adversely affected the value of the loan. Beginning in 1997 and ending in 2007, affiliates of the Company sold loans to securitization trusts and third parties with the potential of such repurchase 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 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.

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.

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”), a wholly-owned subsidiary of the Company, and its 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

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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. Given the early stage of the litigation, the Company cannot provide an estimate of the range of any loss. The Company believes that the affiliated defendants have meritorious defenses to the case and 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, 573 U.S. ___ (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. This litigation is in an early stage, and the Company cannot provide an estimate of the range of any loss. The Company believes that NMFC has meritorious defenses to the case and expects it to defend the case vigorously.

On February 28, 2013 the Federal Housing Finance Agency, as conservator for the Federal Home Loan Mortgage Corporation (Freddie Mac) and on behalf of the Trustee of the NovaStar Mortgage Funding Trust, Series 2007-1 (the "Trust"), a securitization trust in which the Company retains a residual interest, filed a summons with notice in the Supreme Court of the State of New York, County of New York against Novation Companies, Inc. and NovaStar Mortgage, Inc. ("NMI"), a wholly-owned subsidiary of the Company. The notice provides that this is a breach of contract action with respect to certain, unspecified mortgage loans and defendant's failure to repurchase such loans under the applicable agreements. Plaintiff alleges that defendants, from the closing date of the transaction that created the Trust that mortgage loans that were sold to the Trust, were aware of the breach of the representations and warranties made and failed to notice and cure such breaches, and due to the failure of defendants to cure any breach, notice to defendants would have been futile. The summons with notice was not served until June 28, 2013. By letter dated June 24, 2013, the Trustee of the Trust forwarded a notice from Freddie Mac alleging breaches of representations and warranties with respect to 43 loans, as more fully set forth in included documentation. The 43 loans had an aggregate, original principal balance of about $6.5 million. On August 19, 2013, Deutsche Bank National Trust Company, as Trustee, filed a complaint identifying alleged breaches of representations and warranties with respect to seven loans that were included in the earlier list of 43 loans. Plaintiff also generally alleged a trust-wide breach of representations and warranties by defendants with respect to loans sold and transferred to the trust. Plaintiff seeks specific performance of repurchase obligations; compensatory, consequential, recessionary and equitable damages for breach of contract; specific performance and damages for anticipatory breach of contract; and indemnification (indemnification against NMI only). 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. This litigation is in an early stage, and the Company cannot provide an estimate of the range of any loss. The Company believes that it has meritorious defenses to the case and expects to defend the case vigorously.

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Note 9. 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.
•Level 3 – Valuations based on significant unobservable inputs that are supported by little or no market activity, such as discounted cash flow methodologies based on internal cash flow forecasts.

The following tables present for each of the fair value hierarchy levels, the Company's assets which are measured at fair value on a recurring basis as of September 30, 2014 and December 31, 2013 (dollars in thousands):

		Fair Value Measurements at Reporting Date Using		
Description	Fair Value at September 30, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents:				
Cash	3,289	$3,289	$—	$—
Money market funds	13,206	13,206	—	—
Marketable securities, current:				
Certificates of deposit	200	200	—	—
Corporate notes and bonds	22,227	—	22,227	—
Agency securities	3,130	—	3,130	—
Commercial paper	1,996	—	1,996	—
Mortgage securities	3,461	—	—	3,461
Marketable securities, non-current:				
Corporate notes and bonds	8,576	—	8,576	—
Total	$56,085	$16,695	$35,929	$3,461

		Fair Value Measurements at Reporting Date Using		
Description	Fair Value at December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Mortgage securities	$3,728	$—	$—	$3,728

Valuation Methods and Processes

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

To the extent observable inputs are not available, as is the case with the Company's mortgage securities, the Company estimates fair value using present value techniques and generally does not have the option to choose other valuation methods for these securities. The methods and processes used to estimate the fair value of the Company's mortgage securities are discussed further below. There have been no significant changes to the Company's financial statements as a result from changes to the Company's valuation techniques during the nine months ended September 30, 2014.

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. As discussed above and in Note 4 to the condensed consolidated financial statements, the Company's mortgage securities – available-for-sale, are measured at fair value. These securities are valued at each reporting date using significant unobservable inputs (Level 3) by discounting the expected cash flows using market interest rates commensurate with the credit quality and duration of the investment.

The Company uses the discount rate methodology for determining the fair value of its residual securities. The fair value of the residual securities is estimated based on the present value of future expected cash flows to be received. Management's best estimate of key assumptions, including credit losses, prepayment speeds, forward yield curves and discount rates commensurate with the risks involved, are used in estimating future cash flows.

An independent entity has been engaged to prepare projected future cash flows of the Company's mortgage securities for each reporting period (quarterly) used by management to estimate fair value. The Company's internal finance and accounting staff reviews and monitors the work of the independent entity, including analysis of the assumptions used, retrospective review and preparing an overall conclusion of the value and process. All other fair value analysis, consisting of simple cash flow estimates and discounting techniques, is conducted internally by the Company's internal financial staff. The Company's fair value process is conducted under the supervision of the Chief Financial Officer.

The following table presents certain quantitative information about the significant unobservable inputs used in the fair value measurement for items measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

Description	Valuation Techniques	Significant Unobservable Inputs	Range
Assets:			
Mortgage securities – available-for-sale	Present value analysis	Prepayment rates	5.4% – 12.0%
		Weighted average life (years)	2.0 – 2.0

The significant unobservable inputs used in the fair value measurement of mortgage securities – available-for-sale are prepayment rates and the weighted average life for the underlying mortgage loan collateral. Using a faster (higher) estimated prepayment rate would decrease the value of the securities. The Company uses a weighted average life of 2 years from the reporting date for the expected future estimated cash flows. The future cash flows are highly-dependent upon the performance of the underlying collateral of mortgage loans. The nonperformance risk associated with the collateral is the key reason the Company utilizes such a short weighted average life in its calculation. Assuming a shorter weighted average life would decrease the estimated value of the mortgage securities. Alternatively, assuming a longer weighted average life would increase the estimated value of the mortgage securities.

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The following table provides a reconciliation of the beginning and ending balances for the Company's mortgage securities – available-for-sale, which are measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine and three months ended September 30, 2014 and 2013 (dollars in thousands):

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2014	2013	2014	2013
Balance, beginning of period	$3,728	$3,906	$3,552	$3,402
Increases (decreases) to mortgage securities – available-for-sale:				
Accretion of income (A)	568	580	183	207
Proceeds from paydowns of securities (A)	(484)	(552)	(99)	(148)
Mark-to-market value adjustment	(351)	(415)	(175)	58
Net (decrease) increase to mortgage securities – available-for-sale	(267)	(387)	(91)	117
Balance, end of period	$3,461	$3,519	$3,461	$3,519

(A) Cash received on mortgage securities with no cost basis was $4.8 million and $1.8 million for the nine and three months ended September 30, 2014, respectively and $3.2 million and $1.2 million for the nine and three months ended September 30, 2013, respectively.

Adjustments to assets and liabilities measured at fair value on a recurring and nonrecurring basis did not have a material impact on the earnings of continuing operations for any period presented.

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

The estimated fair values of the Company's financial instruments are as follows as of September 30, 2014 and December 31, 2013 (dollars in thousands):

	As of September 30, 2014		As of December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Restricted cash	$597	$428	$597	$369
Marketable securities	39,590	39,590	3,728	3,728
Financial liabilities:				
Senior notes	$85,518	$15,017	$83,867	$13,119
Note payable to related party	—	—	3,863	2,880

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

Restricted cash – The fair value of restricted cash was estimated by discounting estimated future release of the cash from restriction. Restricted cash is included in the other assets line item in the Company's condensed consolidated balance sheets.

Senior notes – The fair value is estimated by discounting future projected cash flows using a discount rate commensurate with the risks involved. The value of the Senior Notes was calculated assuming that the Company would be required to pay interest at a rate of 1.0% per annum until January 2016, at which time the Company would be required to start paying the Full Rate of three-month LIBOR plus 3.5% 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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Note payable to related party – As of December 31, 2013, the fair value of the note payable to related party was estimated by discounting future projected principal and interest payment cash flows using a discount rate commensurate with the risks involved. The future projected interest payments were calculated assuming the stated rate of 4.0% per annum until maturity in March 2016. As detailed in Note 7, this obligation was terminated on April 16, 2014. As of December 31, 2013, current maturities of the note payable to related party of approximately $1.3 million and noncurrent maturities of $2.6 million are included in the other current liabilities and other liabilities line items, respectively, in the Company's condensed consolidated balance sheets.

Note 10. Income Taxes

For the nine and three months ended September 30, 2014 the Company recorded an income tax benefit from continuing operations of approximately $8.6 million and $1.4 million, respectively. The majority of income tax benefit for the current year relates to operating losses from continuing operations and the utilization of a portion of the Company's deferred tax assets to offset the income tax expense from discontinued operations. For the nine and three months ended September 30, 2014 income tax expense from discontinued operations totaled approximately $8.6 million and $0.8 million, respectively, arising primarily from the gain on the sale of StreetLinks. The net income tax expense for the nine months ended September 30, 2014 was not material. The net income tax benefit of approximately $0.6 million for the three months ended September 30, 2014 relates primarily to a reduction of unrecognized tax benefits of approximately $0.5 million during the quarter due to the lapse of the statute of limitations. During the nine months ended September 30, 2013 the Company recorded an income tax expense of approximately $27.3 million, which represented a discrete event attributable to adjustment of the valuation allowance against the Company's deferred tax assets during the second quarter of 2013.

During 2013, the Company determined that it was no longer more likely than not that it will recognize a portion of its deferred tax assets. Therefore, as of both September 30, 2014 and December 31, 2013, the Company maintained a full valuation allowance against its deferred tax assets of $268.6 million and $283.0 million, respectively. The Company's determination of the extent to which its deferred tax assets will be realized 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 September 30, 2014 and December 31, 2013, the total gross amount of unrecognized tax benefits was $0.6 million and $0.7 million, respectively. These amounts also represent the total amount of unrecognized tax benefits that would impact the effective tax rate in the respective periods. The Company anticipates an additional reduction of the unrecognized tax benefits in the amount of $0.2 million due to the lapse of statute of limitations in the next twelve months.

Note 11. Segment Reporting

As a result of the divestiture activity during the nine months ended September 30, 2014, the Company now reviews, manages and operates its business in only two segments: Corporate and Cloud SaaS. In addition to now only operating as two segments, beginning in June of 2014 and continuing into the third quarter of 2014, the Corporate segment transferred the majority of the employees and assets of its Corvisa Services subsidiary, which formerly provided IT, marketing, and HR services to the Company's portfolio of operating subsidiaries, to the Cloud SaaS segment.

Corporate operating results include mortgage securities retained from securitizations, corporate general and administrative expenses, and, for 2013 only, the operating results of CorvisaCloud, as these results were not significant during the nine and three months ended September 30, 2013. The Cloud SaaS segment represents service fee income and related expenses from the Company's wholly-owned subsidiary, CorvisaCloud. Management evaluates segment performance based on income before income taxes, which is prior to the allocation of losses attributable to the noncontrolling interests.

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The following is a summary of the operating results of the Company's segments for the nine months ended September 30, 2014 and 2013 and a summary of their financial positions as of September 30, 2014 and December 31, 2013 (dollars in thousands):

	Corporate	Cloud SaaS	Eliminations	Discontinued Operations (C)	Total
For the Nine Months Ended September 30, 2014					
Service fee income	$6,385	$2,231	$(4,550)	$—	$4,066
Interest income	5,393	—	(11)	—	5,382
Interest expense	2,359	8	(9)	—	2,358
Depreciation and amortization expense (A)	727	403	—	—	1,130
Loss from continuing operations before income taxes	(2,737)	(8,101)	(3,057)	—	(13,895)
Additions to long-lived assets (B)	413	2,652	(487)	—	2,578
As of September 30, 2014					
Total assets	$60,155	$9,949	$(3,903)	$900	$67,101

(A) Amounts related to continuing operations are included in the cost of services and selling, general and administrative expense line items on the condensed consolidated statements of operations, while amounts related to discontinued operations are included in the (loss) income from discontinued operations, net of income taxes.
(B) Amount includes assets acquired under capital leases. Eliminations relate to intercompany transfers of fixed assets.
(C) See Note 3 for additional information regarding the financial position and operating results of discontinued operations.

	Corporate	Eliminations	Discontinued Operations (C)	Total
For the Nine Months Ended September 30, 2013				
Service fee income	$7,196	$(6,465)	$—	$731
Interest income	4,094	(327)	—	3,767
Interest expense	2,393	(3)	—	2,390
Depreciation and amortization expense (A)	677	—	—	677
Loss from continuing operations before income taxes	(5,372)	(6,909)	—	(12,281)
Additions to long-lived assets	2,252	—	—	2,252
As of December 31, 2013				
Total assets (B)(D)	$25,535	$(8,510)	$17,017	$34,042

(A) Amounts related to continuing operations are included in the cost of services and selling, general and administrative expense line items on the condensed consolidated statements of operations, while amounts related to discontinued operations are included in the (loss) income from discontinued operations, net of income taxes.
(B) Total assets of discontinued operations includes goodwill of $3.2 million resulting from the acquisition of StreetLinks.
(C) See Note 3 for additional information regarding the financial position and operating results of discontinued operations.
(D) Corporate segment includes Cloud SaaS assets of $1.9 million as of December 31, 2013.

The intersegment service fee income for the nine and three months ended September 30, 2014 includes fees charged by the Corporate segment to the Appraisal Management, Financial Intermediary, and Cloud SaaS segments for operational support provided by the Corporate segment's employees. The intersegment interest income and interest expense consists of interest charged by the Corporate segment to the Appraisal Management, Financial Intermediary, and Cloud SaaS segments for borrowings. For the nine months ended September 30, 2013, the intersegment service fee income and interest amounts also include fees charged to the Logistics segment.

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The following is a summary of the operating results of the Company's segments for the three months ended September 30, 2014 and 2013 (dollars in thousands):

	Corporate	Cloud SaaS	Eliminations	Total
For the Three Months Ended September 30, 2014				
Service fee income	$1,196	$705	$(222)	$1,679
Interest income	1,986	—	—	1,986
Interest expense	765	(1)	—	764
Depreciation and amortization expense (A)	209	196	—	405
Loss from continuing operations before income taxes	(478)	(4,457)	(117)	(5,052)
Additions to long-lived assets (B)	110	1,939	—	2,049

(A) Amounts related to continuing operations are included in the cost of services and selling, general and administrative expense line items on the condensed consolidated statements of operations, while amounts related to discontinued operations are included in the (loss) income from discontinued operations, net of income taxes.

(B) Amount includes assets acquired under capital leases.

	Corporate	Eliminations	Total
For the Three Months Ended September 30, 2013			
Service fee income	$2,744	$(2,292)	$452
Interest income	1,369	(7)	1,362
Interest expense	810	(3)	807
Depreciation and amortization expense (A)	264	—	264
Loss from continuing operations before income taxes	(2,216)	(2,353)	(4,569)
Additions to long-lived assets (B)	675	—	675

(A) Amounts related to continuing operations are included in the cost of services and selling, general and administrative expense line items on the condensed consolidated statements of operations, while amounts related to discontinued operations are included in the (loss) income from discontinued operations, net of income taxes.

(B) Amount includes assets acquired under capital leases.

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Note 12. Earnings per Share

Basic earnings per share is computed by dividing net earnings 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 the nine and three months ended September 30, 2014 and 2013 (dollars in thousands, except share and per share amounts) are as follows:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2014	2013	2014	2013
Numerator:				
Net loss from continuing operations	$(5,289)	$(39,570)	$(3,676)	$(4,192)
Net income (loss) from discontinued operations	41,414	11,379	(1,206)	1,915
Net income (loss)	36,125	(28,191)	(4,882)	(2,277)
Less net loss attributable to noncontrolling interests	—	(165)	—	(88)
Net income (loss) available to common shareholders	$36,125	$(28,026)	$(4,882)	$(2,189)
Denominator:				
Weighted average common shares outstanding – basic	90,895,504	90,745,504	90,951,716	90,801,716
Weighted average common shares outstanding – dilutive:				
Weighted average common shares outstanding – basic	90,895,504	90,745,504	90,951,716	90,801,716
Stock options	—	—	—	—
Nonvested shares	—	—	—	—
Weighted average common shares outstanding – dilutive	90,895,504	90,745,504	90,951,716	90,801,716
Basic earnings per share:				
Net loss from continuing operations	$(0.06)	$(0.44)	$(0.04)	$(0.05)
Net income (loss) from discontinued operations	0.46	0.13	(0.01)	0.02
Net income (loss)	0.40	(0.31)	(0.05)	(0.03)
Less net loss attributable to noncontrolling interests	—	—	—	(0.01)
Net income (loss) available to common shareholders	$0.40	$(0.31)	$(0.05)	$(0.02)
Diluted earnings per share:				
Net loss from continuing operations	$(0.06)	$(0.44)	$(0.04)	$(0.05)
Net income (loss) from discontinued operations	0.46	0.13	(0.01)	0.02
Net income (loss)	0.40	(0.31)	(0.05)	(0.03)
Less net loss attributable to noncontrolling interests	—	—	—	(0.01)
Net income (loss) available to common shareholders	$0.40	$(0.31)	$(0.05)	$(0.02)

The following weighted-average options to purchase shares of Common Stock were outstanding during each period presented, but were not included in the computation of diluted earnings per share because the calculated number of shares assumed to be repurchased was greater than the number of shares to be obtained upon exercise, therefore, the effect would be antidilutive (in thousands, except exercise prices):

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2014	2013	2014	2013
Number of stock options	9,622	8,435	11,486	8,578
Weighted average exercise price of stock options	$0.66	$0.69	$0.64	$0.68

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During the nine months ended September 30, 2014, the Company granted 3.3 million options to purchase shares of Common Stock at a weighted average exercise price of $0.51. Approximately 0.3 million options were granted during the three months ended September 30, 2014 at a weighted average exercise price of $0.51. The weighted average impact of 1.1 million and 3.0 million options granted during the current year are included in the table above for the nine and three months ended September 30, 2014, respectively.

During the nine months ended September 30, 2013, the Company granted 0.6 million options to purchase shares of Common Stock at a weighted average exercise price of $0.53. The weighted average impact of 0.4 million and 0.6 million are included in the table above for the nine and three months ended September 30, 2013, respectively. There were no options granted during the three months ended September 30, 2013.

The Company had approximately 0.5 million and 0.6 million nonvested shares outstanding as of September 30, 2014 and September 30, 2013, respectively, which have original cliff vesting schedules ranging between five and ten years. Of these, the weighted average impact of approximately 0.6 million and 0.5 million nonvested shares for the nine and three months ended September 30, 2014, respectively and 0.7 million nonvested shares for both the nine and three months ended September 30, 2013 were not included in the calculation of earnings per share because they were anti-dilutive.

Note 13. Shareholders’ Deficit

As detailed in Note 7, on April 16, 2014, the Company and Mr. Haslam agreed to terminate the Unit Purchase Agreement. In full satisfaction of the Company's outstanding obligation under the Unit Purchase Agreement, the Company transferred back to Mr. Haslam 1,218 StreetLinks membership units, which represents the portion of the membership units attributable to the $3.9 million in unpaid installment payments and $0.2 million in interest remaining under the Unit Purchase Agreement. In accordance with the relevant accounting guidance, the termination of the Unit Purchase Agreement and simultaneous transfer of ownership interests was treated as an equity transaction, increasing additional paid in capital and StreetLinks' noncontrolling interest by approximately $3.8 million and $0.1 million, respectively, with no corresponding gain or loss recognized in the condensed consolidated statement of operations.

In connection with the Company's issuance of convertible preferred stock in 2007, which was subsequently exchanged for shares of newly-issued common stock in 2011, the Company accrued an estimate for offering costs incurred by the preferred stock investors. In accordance with the relevant accounting guidance, the Company originally recorded these costs to additional paid in capital as a reduction of the proceeds from issuance. As the statute of limitations whereby the investors may claim the expenses lapsed during the three months ended September 30, 2013, the Company adjusted the estimated accrued offering costs, resulting in a $1.8 million increase to additional paid in capital.

Noncontrolling Interests – During the nine months ended September 30, 2013, the Company distributed approximately $0.7 million of excess capital, as determined in accordance with the StreetLinks operating agreement, to the noncontrolling members of StreetLinks. Each member's share of the distribution is determined based on their ownership interest at the time of the distribution.

During the second quarter of 2013, the Company foreclosed on the membership interests of the noncontrolling members in full satisfaction of Advent's outstanding intercompany debt obligations. In accordance with the relevant accounting guidance, this debt extinguishment was treated as an equity transaction, reducing Advent's noncontrolling interest deficit by approximately $1.9 million. See Note 5 for additional information regarding this acquisition.

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

Forward-Looking Statements

Statements in this report regarding Novation Companies, Inc. 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. 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. Actual results and operations for any future period may vary materially from those discussed herein. Some important factors that could cause actual results to differ materially from those anticipated include: our ability to manage our business; variability in the home mortgage or refinancing market that affects the demand for real estate appraisal services; changes in the regulatory environments within which our subsidiaries operate; our ability to develop new relationships and maintain existing relationships with both customers and business partners; decreases in cash flows from our mortgage securities; our ability to remain in compliance with the agreements governing our indebtedness; the outcome of litigation actions pending against us or other legal contingencies; our compliance with applicable local, state and federal laws and regulations; compliance with new accounting pronouncements; the impact of general economic conditions; and the risks that are from time to time included in our filings with the Securities and Exchange Commission (“SEC”), including the Company's most recent Annual Report on Form 10-K and this report on Form 10-Q. Other factors not presently identified may also cause actual results to differ. This report on Form 10-Q speaks only as of its date and we expressly disclaim any duty to update the information herein except as required by applicable law.

Executive Overview

The following Management's Discussion and Analysis of Financial Condition and Operating Results (“MD&A”) should be read in conjunction with the preceding unaudited condensed consolidated financial statements of Novation Companies, Inc. and its subsidiaries (the “Company” or ”Novation" or “we” or “us”) and the notes thereto as well as the Company's Annual Report on Form 10-K for the year ended December 31, 2013. MD&A includes the following sections:

- Corporate Overview, Background and Strategy – a brief overview of our business, current strategy, and significant recent events.
- Critical Accounting Policies – an update, since December 31, 2013, of our discussion of accounting policies that impact our financial statements and involve a high degree of judgment or complexity. This section also includes the impact of new accounting standards.
- Consolidated Results of Operations – an analysis of our results of operations for the nine months ended September 30, 2014 and 2013 as presented in our unaudited Condensed Consolidated Financial Statements.
- Segment Results of Operations – an analysis of our results of operations for the nine months ended September 30, 2014 and 2013 as presented in our unaudited Condensed Consolidated Financial Statements for our reporting segments.
- Liquidity and Capital Resources – an analysis of our cash flows and financial commitments.

Corporate Overview, Background and Strategy

Our Business

Novation Companies, Inc. (the “Company” or "Novation” or "we” or “us”) is a Maryland corporation formed on September 13, 1996.

CorvisaCloud, LLC (CorvisaCloud) is a developer and seller of proprietary cloud-based contact center software and private branch exchange (PBX) systems. In addition, CorvisaCloud provides implementation consulting services for clients of a leading customer relationship management (CRM) software.

On August 18, 2014, the Company announced that it would be conducting an orderly winding-down of the remaining business and operations of Advent Financial Services LLC (“Advent”) a financial settlement services provider for professional tax preparers nationwide. As discussed in Note 3, the operations of Advent have been classified as discontinued operations for all periods presented.

On April 16, 2014, the Company and the non-controlling members of StreetLinks, a national residential appraisal and mortgage real estate valuation management services company, entered into a purchase and sale agreement with Assurant Services, LLC, a subsidiary of Assurant, Inc. ("Assurant"), pursuant to which Assurant purchased 100% of the outstanding membership units of StreetLinks. See Note 3 to the condensed consolidated financial statements for additional information regarding this transaction.

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In each of these businesses we invested at the early stage of the company’s life with the goal of growing each business to its maximum potential. When we acquire businesses, our goal is to own indefinitely. However, we may consider the sale of a business or businesses if we believe we can invest the proceeds from a sale elsewhere at a better risk adjusted long term return for shareholders. This may include investing capital in a business we already own or investing in an unrelated business not yet identified.

On April 16, 2014 we announced a significant strategic shift for Novation with the sale of StreetLinks and the decision to focus our resources primarily on the business of CorvisaCloud. This decision was based largely on the Company's belief that CorvisaCloud represents a better opportunity for Novation to build long-term shareholder value due to CorvisaCloud's CorvisaOne™ technology platform and the size of its target customer base. What follows is a detailed discussion of the CorvisaCloud business. Note 11 to the condensed consolidated financial statements set forth in Item 1 of this report, which is incorporated by reference, includes information about the operating results and financial position of the segments to which this business relates.

CORVISACLOUD, LLC

CorvisaCloud is a provider of cloud-based, proprietary communication software under the brand CorvisaOne™ and implementation consulting services for its own clients as well as clients of a leading customer relationship management (CRM) software provider.

CorvisaOne™ is a full contact center suite including both inbound and outbound contact center functionality as well as full private branch exchange (PBX) phone system functionality. Features of the communications software include interactive voice response, automated call distribution, campaign dialing, and a variety of other services, all of which are delivered to clients as part of a comprehensive, fully-hosted cloud solution. The software is fully integrated with the leading CRM provider and can be integrated with other third party software solutions via our advanced web service, JavaScript and platform integration solutions. CorvisaCloud's target customers are businesses of all sizes in all industries, anywhere in the world.

We acquired CorvisaCloud in October 2012 and set out to build a complete cloud-based contact center software solution. By joining the years of contact center operating experience possessed by Novation’s leadership team with the technology team acquired through the CorvisaCloud acquisition, we believe we have built a best-in-class contact center software solution. In addition to the product offering, CorvisaCloud has built its product as part of a platform that enables its customers and others to develop their own tools to tie into CorvisaCloud's product offering.

In addition to the benefits associated with cloud-based technology solutions such as security, scalability, reliability, rapid deployment and low cost, additional business benefits to customers using CorvisaCloud's technology product/platform include:

Integrated Cloud PBX (phone system) within CorvisaCloud's contact center application. This integration enables executives and contact center employees to be on the same platform and eliminates the need for separate contact center and PBX vendors.

Platform in addition to CorvisaCloud's product. CorvisaCloud's platform provides a highly configurable platform that allows for the creation or editing of voice and SMS applications utilizing Summit, CorvisaCloud's Lua-based programming language. Applications built on the CorvisaOne™ platform are fully hosted on the CorvisaCloud network that provides scalability, redundancy, backup, testing frameworks and other features required for enterprise-class applications. Existing applications or those developed by third-party developers can also easily be integrated through our open APIs. This makes it easy for developers to scale with their application and effectively support their product while eliminating the need to manage independent server and hosting environments.

Contact and Campaign Manager. CorvisaOne™ includes a highly scalable contact/lead management system allowing for dynamic management of millions of contact/lead records, including real-time assignment to dialing campaigns. This functionality eliminates the need to store and manage complex campaign logic in third-party systems or manual spreadsheets. In addition, CorvisaOne™ supports real-time synchronization with leading CRM systems to allow customers to work seamlessly within their CRM.

Redundant Instance-based Architecture. CorvisaCloud's highly scalable, instance-based architecture allows CorvisaOne™ to scale to support a worldwide presence while providing customer benefits such as read access to their client data, segmented client data and a highly redundant architecture.

Combined Telecom and Production Reporting. As business operators ourselves, we believe strongly in the importance of closely aligning telecommunications and production data to give greater visibility into overall business operations. The CorvisaOne™ product is tightly integrated with leading CRM systems to ensure accurate and comprehensive business reporting.

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CorvisaCloud derives its revenue from software subscription fees for its product and certain usage-based fees, such as customers' usage of telecommunications minutes. CorvisaCloud also derives revenue from professional service fees charged for enhanced implementation requirements of its contact center solution as well as CRM implementation services.

Our plan over time is to sell CorvisaCloud's product and services through its direct sales force which is comprised of telephone sales personnel located regionally. For larger opportunities CorvisaCloud will send its implementation teams on site in a consulting role to help onboard clients.

CorvisaCloud's marketing strategy is to promote its brand and generate quality leads for its sales force. CorvisaCloud's primary marketing activities will consist of:

- Press and industry analyst relations for third-party validation of the CorvisaCloud offering and value proposition
- Attendance at user conferences and trade show events
- Search engine marketing and advertising to drive leads to the CorvisaCloud sales force
- Use of customer testimonials and referrals
- Leads from the CorvisaCloud CRM implementation practice

On April 23, 2014, the Company announced that it would be devoting up to $30 million of the proceeds from the StreetLinks sale to CorvisaCloud. The additional capital will be used to expand CorvisaCloud's sales, marketing and operational development efforts and, potentially, fund potential acquisitions. The funds will also be used to accelerate product development and customer acquisition of CorvisaCloud's CorvisaOne™ contact center software products and platform. As of September 30, 2014, the Company contributed approximately $12.3 million of the allotted $30 million to CorvisaCloud.

Our Strategy

Management is focused on building its operating subsidiaries with a focus on long-term value creation. As previously noted, on April 16, 2014 we announced a significant strategic shift for Novation with the sale of StreetLinks and the decision to focus our resources primarily on the business of CorvisaCloud. Given the early-stage nature of this business, it may not contribute to quarterly earnings for some time but we believe CorvisaCloud represents a solid investment with the opportunity for future earnings and equity value creation that will benefit shareholders. Key performance measures for executive management are:

- generating income and long-term value for our shareholders, and
- maintaining and/or generating adequate liquidity to sustain us and allow us to take advantage of acquisition opportunities.

The following key performance metrics are derived from our condensed 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.”

Table 1 – Summary of Financial Highlights and Key Performance Metrics (dollars in thousands; except per share amounts)

	For the Nine Months Ended September 30,	
	2014	2013

Net income (loss) available to common shareholders per diluted share	$0.40	$(0.31)

	As of September 30, 2014	December 31, 2013
Unrestricted cash and cash equivalents	$16,495	$5,768

Significant Recent Events

On August 18, 2014, Advent sold certain intellectual property, software, and customer data to Santa Barbara Tax Products Group, LLC, for cash consideration of $1.0 million paid at closing. The transaction resulted in a gain of approximately $0.8 million, which is included in the net income from discontinued operations line on the condensed consolidated statement of operations.

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Also on August 18, 2014, the Company announced that it was conducting an orderly winding-down of Advent's remaining business and operations. As the run-off operations were substantially complete as of September 30, 2014, and as the Company will not have any significant continuing involvement in Advent, the operations of Advent have been classified as discontinued operations for all periods presented.

Critical Accounting Policies

In our Annual Report on Form 10-K for the year ended December 31, 2013, we disclose critical accounting policies that require management to use significant judgment or that require significant estimates. Management regularly reviews the selection and application of our critical accounting policies. There have been no updates to the critical accounting policies contained in our Annual Report on Form 10-K for the year ended December 31, 2013.

Impact of Recently Issued Accounting Pronouncements

In August 2014, the FASB issued Accounting Standards Updated ("ASU") 2014-15, Presentation of Financial Statements-Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, which provides guidance on determining when and how reporting entities must disclose going-concern uncertainties in their financial statements. The new standard requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date of issuance of the entity's financial statements (or within one year after the date on which the financial statements are available to be issued, when applicable). Further, an entity must provide certain disclosures if there is "substantial doubt about the entity's ability to continue as a going concern." This ASU is effective for annual periods ending after December 15, 2016, and interim periods thereafter. Early adoption is permitted. The Company does not expect this guidance to have a significant impact on the Company's financial statements.

In May 2014, the FASB issued Accounting Standards Updated ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The ASU applies to all contracts with customers except those that are within the scope of other topics in the FASB Accounting Standards Codification. Compared with current U.S. GAAP, the ASU also requires significantly expanded disclosures about revenue recognition. The ASU is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016. Early application is not permitted. The Company is evaluating the impact of ASU 2014-09 on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

In April 2014, the FASB issued ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which amends the definition of a discontinued operation in ASC 205-20 and requires entities to provide additional disclosures about discontinued operations as well as disposal transactions that do not meet the discontinued-operations criteria. The FASB issued the ASU to provide more decision-useful information and to make it more difficult for a disposal transaction to qualify as a discontinued operation. The ASU is effective prospectively for all disposals (except disposals classified as held for sale before the adoption date) or components initially classified as held for sale in periods beginning on or after December 15, 2014. Early adoption is permitted. The impact of the adoption of ASU 2014-08 on the Company's financial statements will be based on future disposal activity.

In September 2013, the U.S. Department of the Treasury and the IRS released final regulations providing guidance on the application of IRC Section 263(a) to amounts paid to acquire, produce, or improve tangible property, as well as rules for materials and supplies ("Tangible Property Regulations"). While the final regulations are generally effective for taxable years beginning on or after January 1, 2014, taxpayers are permitted to early adopt provisions for years beginning on or after January 1, 2012. This guidance did not have a significant impact on the Company's financial statements.

In July 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force), which provides guidance on financial statement presentation of an unrecognized tax benefit when a net operating loss (NOL) carryforward, a similar tax loss, or a tax credit carryforward exists. The FASB's objective in issuing this ASU is to eliminate diversity in practice resulting from a lack of guidance on this topic in current U.S. GAAP. This ASU applies to all entities with unrecognized tax benefits that also have tax loss or tax credit carryforwards in the same tax jurisdiction as of the reporting date and is effective for fiscal years beginning after December 15, 2013, and interim periods within those years. This guidance did not have a significant impact on the Company's financial statements.

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Consolidated Results of Operations

Service Fee Income and Cost of Services

On a consolidated basis, service fee income increased to $4.1 million for the nine months ended September 30, 2014 from $0.7 million for the nine months ended September 30, 2013. For the three months ended September 30, 2014 service fee income increased to $1.7 million from $0.5 million for the prior year period. The increase in all periods is driven primarily by the growth of CorvisaCloud and its customer base. In addition, service fee income for the nine and three months ended September 30, 2014 includes approximately $2.1 million and $1.1 million, respectively, of professional service fees earned by the ongoing entity under the transition services agreement with Assurant. Cost of services for nine and three months ended September 30, 2014 includes approximately $1.3 million and $0.7 million, respectively, of salaries and related expenses incurred to provide these transition services.

Interest Income – Mortgage Securities

Interest income on the marketable securities we own increased to approximately $5.4 million during the nine months ended September 30, 2014 compared to $3.8 million during the nine months ended September 30, 2013. During the three months ended September 30, 2014, interest income on marketable securities totaled $2.0 million compared to $1.4 million during the same period in 2013. The increase in all periods was attributable to our mortgage securities and was due primarily to lower than anticipated losses on the underlying loan collateral, which led certain securities to begin cash-flowing during the current year period after extended periods of inactivity. Management does not expect this trend to continue on a long-term basis. Instead, the Company expects interest income and cash flow from these securities to decline as the principal on the underlying loan collateral is paid or written down or off.

Selling, General and Administrative

On a consolidated basis, selling, general and administrative expenses increased to $16.8 million for the nine months ended September 30, 2014 from $14.5 million for the nine months ended September 30, 2013. For the quarter, selling, general and administrative expenses increased to $5.8 million from $4.9 million for prior year period. The increase in all periods was driven largely by the operations of the Company's Cloud SaaS segment, which saw increases in headcount, marketing and promotional activities, professional services, and IT support costs as this segment continues to focus on growing its existing customer base and enhancing its product offerings and features. As discussed in Note 8, for the nine and three months ended September 30, 2014, selling, general and administrative expenses also include $0.4 million of severance expense related to Mr. Haslam's termination.

Other Income (Expense)

Other income was not material during the nine and three months ended September 30, 2014. During the nine months ended September 30, 2013, other income totaled approximately $0.9 million, which was primarily attributable to the recovery of credit losses related to a note receivable. Other expense of $0.4 million for three months ended September 30, 2013 is comprised primarily of the abandonment of certain internal-use software associated with an earlier instance of the CorvisaCloud product.

Interest Expense

Interest expense was materially consistent period over period, with the Company incurring approximately $2.4 million during the nine months ended September 30, 2014 and 2013 and $0.8 million for the three months ended September 30, 2014 and 2013. See Note 7 to the condensed consolidated financial statements for additional information regarding the Company's borrowings.

Income Tax Benefit (Expense)

For the nine and three months ended September 30, 2014 the Company recorded an income tax benefit from continuing operations of approximately $8.6 million and $1.4 million, respectively, which relates primarily to current year operating losses from continuing operations and the utilization of a portion of the Company's deferred tax assets to offset the income tax expense from discontinued operations. During the nine months ended September 30, 2013 the

Company recorded an income tax expense of approximately $27.3 million, which represented a discrete event attributable to adjustment of the valuation allowance against the Company's deferred tax assets during the second quarter of 2013. See Note 10 to the condensed consolidated financial statements for further details regarding the Company's income tax provision and deferred tax assets.

Segment Results of Operations

Cloud SaaS

We earn call center technology fees through software licenses, inbound and outbound minute usage, ancillary fees, and implementation services. Once implemented, clients pay a software as a service (SaaS) fee for a contact center seat license or PBX license, as well as a per minute fee for inbound and outbound minutes used. Minute fees can also be generated from the use of our interactive voice response software. Cost of Services represents both the direct and other costs of providing these services, including but not limited to software development, fees to third party telecommunications carriers, compensation-related expenses, and other expenses necessary to complete services performed.

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We earn professional service fees for providing CRM implementation, support and administrative services to our clients. Cost of Services includes the direct costs of providing these services, which consist primarily of compensation-related expenses.

Following is an analysis of the results of operations from the Cloud SaaS segment.

Table 4 – Cloud SaaS Segment Operations (dollars in thousands)

	For the Nine Months Ended September 30, 2014		For the Three Months Ended September 30, 2014	
	Total	%	Total	%
Service fee income:				
Professional services	$1,353	60.6 %	$396	56.2 %
Call center technology	878	39.4	309	43.8
Total service fee income	2,231	100.0	705	100.0
Cost of services	3,744	167.8	1,538	218.2
Selling, general and administrative expense	6,592	295.5	3,630	514.9
Total expenses	10,336	463.3	5,168	733.0
Other income, net	4	0.2	6	0.9
Net loss before income taxes	$(8,101)	(363.1)%	$(4,457)	(632.2)%

Service Fee Income
Service fee income for the Cloud SaaS segment totaled $2.2 million and $0.7 million during the nine and three months ended September 30, 2014, respectively. Service fee income was comprised primarily of professional service fees related to implementations of third party CRM software. In addition to being a significant source of revenue for CorvisaCloud during the current quarter and for the foreseeable future, these implementation services are expected to serve as a lead source for CorvisaCloud's CorvisaOne™ suite, which was launched during the fourth quarter of 2013.

Cost of Services
Cost of services totaled $3.7 million for the nine months ended September 30, 2014 and $1.5 million for the three months ended September 30, 2014. This amount consists of the direct costs of providing professional and other services, in addition to other compensation-related expenses, depreciation, software licenses, and IT support costs. As this segment is still in the early stages of development, Management continues to identify and explore opportunities to scale the business and improve the efficiency of operations with the intent to generate positive margins.

Selling, General and Administrative
Selling, general and administrative expenses for the nine and three months ended September 30, 2014 totaled $6.6 million and $3.6 million, respectively. This amount is comprised primarily of compensation-related expenses, marketing and promotional expenses, professional services, and IT support costs, as the Company continues to develop, maintain and expand its IT infrastructure and support staff to accommodate the anticipated growth of this segment.

The sequential quarter over quarter increase in selling, general, and administrative expenses for the Cloud SaaS segment is driven primarily by significant growth in headcount. The growth in the Cloud SaaS headcount is due to increased hiring in the Company's development and sales and marketing departments, as well as the transfer of certain IT and human resources employees from the Company's Corporate segment to the Cloud SaaS segment. The remainder of the sequential quarter over quarter increase is due to marketing and promotional activities including, but not limited to, the purchase of sales leads.

As this segment is still in the early stages of development, selling, general and administrative expenses are significantly higher as a percentage of service fee income than we would anticipate going forward. As we continue to grow and develop this business, we anticipate this percentage will decline, as many of these costs should not increase proportionate to production.

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Liquidity and Capital Resources

As of September 30, 2014, we had approximately $16.5 million in unrestricted cash and cash equivalents and $0.6 million of restricted cash, which is included in the other noncurrent assets line item on the condensed consolidated balance sheet. In addition, the Company held approximately $36.1 million in corporate notes and bonds, agency securities, and commercial paper with average remaining maturities between five and eighteen months. These securities are classified as available-for-sale as of September 30, 2014 and are included in the marketable securities, current and marketable securities, non-current line items on the condensed consolidated balance sheet.

Our current projections indicate that sufficient cash and cash flows are and will be available to meet payment needs. It is important to note, though, that our mortgage securities cash flows are volatile and uncertain, and the amounts we receive could vary materially from our projections. Further, given the early stage nature of CorvisaCloud, this business may not contribute to quarterly earnings for some time as it continues to invest for long-term growth. However, we believe that the proceeds from the StreetLinks sale will be sufficient to offset any reductions in our mortgage securities cash flows, as well as absorb the operating cash needs of CorvisaCloud until this business is able to generate positive cash flows on a consistent basis. As discussed under the heading “Item 1. Legal Proceedings” of Part II of this report, we are also the subject of various legal proceedings, the outcomes of which are uncertain. We may also face demands in the future that are unknown to us today related to our legacy lending and servicing operations. Management believes that its current operations and its available cash are sufficient for the Company to discharge its liabilities and meet its commitments in the normal course of business.

The indentures governing the Senior Notes (the “Indentures”) contain restrictive covenants (the “Negative Covenants”) subject to exceptions in the Indentures, including written consent of the holders of the Senior Notes. The Negative Covenants prohibit NCI and its subsidiaries, from among other things, incurring debt, permitting any lien upon any of its property or assets, making any cash dividend or distribution or liquidation payment, acquiring our shares or equity in our subsidiaries, making payment on our debt securities that rank pari passu or junior to the Senior Notes, or disposing of any equity interest in our subsidiaries or all or substantially all of the assets of our subsidiaries. The Senior Notes accrue interest at a rate of 1.0% until the earlier of (a) the completion of an equity offering by NCI or our subsidiaries that results in proceeds of $40 million or more or (b) January 1, 2016. Thereafter, the Senior Notes will accrue interest at a rate of three-month LIBOR plus 3.5% (the “Full Rate”). Interest on the Senior Notes is paid on a quarterly basis and no principal payments are due until maturity on March 30, 2033. The Negative Covenants remain in effect until both of the following conditions are met: 1) the Senior Notes begin accruing interest at the Full Rate, and 2) the Company satisfies certain financial covenants (the “Financial Covenants”). Satisfaction of the Financial Covenants requires the Company to demonstrate on a consolidated basis that (1) its Tangible Net Worth is equal to or greater than $40 million, and (2) either (a) the Interest Coverage Ratio is equal to or greater than 1.35x, or (b) the Leverage Ratio is not greater than 95%. As the Senior Notes were not accruing interest at the Full Rate, the Negative Covenants, as defined above, were still in effect as of September 30, 2014 and December 31, 2013. Compliance with the Financial Covenants is required only when the Company seeks to take action prohibited by the Negative Covenants that has not been approved by the holders of the Senior Notes.

As discussed in Note 3, the Company and the non-controlling members of StreetLinks entered into a purchase and sale agreement with Assurant, pursuant to which Assurant purchased 100% of the outstanding membership units of StreetLinks. The sale of a subsidiary is not prohibited by the Negative Covenants, provided that the sale is at fair market value and the proceeds are reinvested in the Company. As such, the Company was in compliance with all Negative Covenants as of September 30, 2014 and December 31, 2013, and therefore the Company was under no obligation to comply with the Financial Covenants during these periods.

Other than Mr. Haslam's severance and the ManyWho OEM agreement, both of which are discussed in Note 8 to the condensed consolidated financial statements, which is incorporated herein by reference, there have been no significant changes to the Company's contractual obligations as presented in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

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Overview of Cash Flow for the Nine Months Ended September 30, 2014

The following table provides a summary of our operating, investing and financing cash flows as taken from our condensed consolidated statements of cash flows for the nine months ended September 30, 2014 and 2013.

Table 5 – Summary of Operating, Investing and Financing Cash Flows (dollars in thousands)

	For the Nine Months Ended September 30,	
	2014	2013
Consolidated Statements of Cash Flows:		
Cash used in operating activities of continuing operations	$(3,300)	$(4,550)
Cash flows provided by investing activities of continuing operations	15,965	77
Cash flows (used in) provided by financing activities of continuing operations	(1,938)	4,963

Operating Activities

The decrease in net cash flows used in operating activities from $4.6 million during the nine months ended September 30, 2013 to $3.3 million during the nine months ended September 30, 2014 is driven primarily by collections of amounts due from discontinued operations offset by the operations of CorvisaCloud.

Investing Activities

The increase in the net cash flows provided by investing activities is due primarily to the cash proceeds received from the sale of StreetLinks offset by purchases of marketable securities.

Financing Activities

The decrease in the net cash flows provided by financing activities when comparing the nine months ended September 30, 2014 and 2013 is due to a decrease in cash received from distributions of excess StreetLinks capital. Further contributing to the decrease in cash flows provided by financing activities is the increase in cash payments for capital contributions to discontinued entities.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As a smaller reporting company, we are not required to provide the information required by this Item.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company maintains a system of disclosure controls and procedures that are designed to ensure that information required to be disclosed by the Company in reports that it files or submits under the federal securities laws, including this report, is recorded, processed, summarized and reported, within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Company's principal executive officer and principal financial officer evaluated the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(d)) as of the end of the period covered by this report and concluded that the Company's controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There were no changes in our internal controls over financial reporting during the three months ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings
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.

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.

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”), a wholly-owned subsidiary of the Company, and its 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. Given the early stage of the litigation, the Company cannot provide an estimate of the range of any loss. The Company believes that the affiliated defendants have meritorious defenses to the case and 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, 573 U.S. ___ (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. This litigation is in an early stage, and the Company cannot provide an estimate of the range of any loss. The Company believes that NMFC has meritorious defenses to the case and expects it to defend the case vigorously.

On February 28, 2013 the Federal Housing Finance Agency, as conservator for the Federal Home Loan Mortgage Corporation (Freddie Mac) and on behalf of the Trustee of the NovaStar Mortgage Funding Trust, Series 2007-1 (the "Trust"), a securitization trust in which the Company retains a residual interest, filed a summons with notice in the Supreme Court of the State of New York, County of New York against Novation Companies, Inc. and NovaStar Mortgage, Inc. ("NMI"), a wholly-owned subsidiary of the Company. The notice provides that this is a breach of contract action with respect to certain, unspecified mortgage loans and defendant's failure to repurchase such loans under the applicable agreements. Plaintiff alleges that defendants, from the closing date of the transaction that created the Trust that mortgage loans that were sold to the Trust, were aware of the breach of the representations and warranties made and failed to notice and cure such breaches, and due to the failure of defendants to cure any breach, notice to defendants would have been futile. The summons with notice was not served until June 28, 2013. By letter dated June 24, 2013, the Trustee of the Trust forwarded a notice from Freddie Mac alleging breaches of representations and warranties with respect to 43 loans, as more fully set forth in included documentation. The 43 loans had an aggregate, original principal balance of about $6.5 million. On August 19, 2013, Deutsche Bank National Trust Company, as Trustee, filed a complaint identifying alleged breaches of representations and warranties with respect to seven loans that were included in the earlier list of 43 loans. Plaintiff also generally alleged a trust-wide breach of representations and warranties by defendants with respect to loans sold and transferred to the trust. Plaintiff seeks specific performance of repurchase obligations; compensatory, consequential, recessionary and equitable damages for breach of contract; specific performance and damages for anticipatory breach of contract; and indemnification (indemnification against NMI only). 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. This litigation is in an early stage, and the Company cannot provide an estimate of the range of any loss. The Company believes that it has meritorious defenses to the case and expects to defend the case vigorously.

Item 1A. Risk Factors

Risk Factors

There have been no material changes to the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

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

(dollars in thousands, except per share amounts)

Issuer Purchases of Equity Securities

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs (A)
July 1, 2014 - July 31, 2014	—	—	—	$1,020
August 1, 2014 - August 31, 2014	—	—	—	$1,020
September 1, 2014 - September 30, 2014	—	—	—	$1,020

(A) A current report on Form 8-K was filed on October 2, 2000 announcing that the Board of Directors authorized the Company to repurchase its common shares, bringing the total authorization to $9 million. The Company has repurchased $8.0 million to date, leaving approximately $1.0 million of shares that may yet be purchased under the plan.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit Listing

Exhibit No.	Description of Document
31.1	Chief 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	Chief 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 Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, formatted in XBRL (Extensible Business Reporting Language) includes: (i) Consolidated Balance Sheets as of September 30, 2014 and December 31, 2013, (ii) Consolidated Statements of Operations for the nine and three months ended September 30, 2014 and 2013, (iii) Consolidated Statements of Comprehensive Income for the nine and three months ended September 30, 2014 and 2013, (iv) Consolidated Statements of Shareholders' Equity for the nine months ended September 30, 2014 and 2013, (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2014 and 2013, and (vi) the Notes to Consolidated Financial Statements.

* Management contract of compensatory plan or arrangement

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SIGNATURES

Pursuant to the requirements 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: November 6, 2014	/s/ W. Lance Anderson W. Lance Anderson, Chairman of the Board of Directors and Chief Executive Officer (Principal Executive Officer)
DATE: November 6, 2014	/s/ Rodney E. Schwatken Rodney E. Schwatken, Chief Financial Officer (Principal Financial Officer)
DATE: November 6, 2014	/s/ Brett A. Monger Brett A. Monger, Vice President and Chief Accounting Officer (Principal Accounting Officer)