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NOVASTAR FINANCIAL INC
Form 8-K
March 20, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

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

March 17, 2008
Date of Report (Date of earliest event reported)

NOVASTAR FINANCIAL, INC.
(Exact name of registrant as specified in its charter)

Maryland	001-13533	74-2830661

(State or other jurisdiction of incorporation or organization)	(Commission File Number)	(I.R.S. Employer Identification No.)
8140 Ward Parkway, Suite 300, Kansas City, MO 64114		

(Address of principal executive offices) (Zip Code)		
(816) 237-7000		

(Registrant's telephone number, including area code)		
Not Applicable		

(Former Name or Former Address, if Changed Since Last Report)		

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 1.01 Entry into a Material Definitive Agreement

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On March 17, 2008, NovaStar Financial, Inc. ("NFI"), NovaStar Mortgage, Inc. ("NMI"), NFI Holding Corp. ("NFI Holding") and NovaStar Home Mortgage, Inc. ("NHMI" and, with NFI, NMI and NFI Holding, the "NovaStar Entities") and American Interbank Mortgage, LLC ("Plaintiff") entered into a Confidential Settlement Term Sheet Agreement (the "Settlement Terms") with respect to the actions, judgments and claims described below.

In March 2002, Plaintiff filed an action against NHMI in Superior Court of Orange County, California entitled American Interbank Mortgage LLC v. NovaStar Home Mortgage, Inc. et. al. (the "California Action").

In the California Action, Plaintiff alleged that NHMI and two other mortgage companies ("Defendants") engaged in false advertising and unfair competition under certain California statutes and interfered intentionally with Plaintiff's prospective economic relations. On May 4, 2007, a jury returned a verdict by a 9-3 vote awarding Plaintiff \$15.9 million. The court trebled the award, made adjustments for amounts paid by settling Defendants, and entered a \$46.1 million judgment against Defendants on June 27, 2007. The award is joint and several against the Defendants, including NHMI. It is unknown if the other two Defendants, one of which has filed a bankruptcy petition, have the financial ability to pay any of the award.

NHMI's motion for the trial court to overturn or reduce the verdict was denied on August 20, 2007, and NHMI appealed that decision (the "Appeal"). Pending the Appeal, Plaintiff commenced enforcement actions in the states of Missouri (the "Kansas City Action") and Delaware, and obtained an enforcement judgment in Delaware (the "Delaware Judgment"). On January 23, 2008, Plaintiff filed an involuntary petition for bankruptcy against NHMI under 11 U.S.C. Sec. 303, in the United States Bankruptcy Court for the Western District of Missouri (the "Involuntary"). Plaintiff was joined by two individuals alleging claims totaling \$150 in the Involuntary filing. NHMI filed an answer and contested the standing of Plaintiff and the individuals to be petitioning creditors in bankruptcy.

On March 17, 2008, the NovaStar Entities and Plaintiff entered into the Settlement Terms with respect to the California Action, the Judgment, the Kansas City Action, the Delaware Judgment, the Involuntary, and all related claims. The parties agreed to negotiate a longer-form definitive settlement agreement to replace the Settlement Terms but, absent execution of such an agreement by March 24, 2008, the Settlement Terms become the final, binding settlement agreement between the parties.

Under the Settlement Terms, the parties agreed to move to dismiss the Involuntary. Within ten (10) business days after notice of entry of the dismissal of the Involuntary, the NovaStar Entities will pay Plaintiff \$2,000,000 plus the balance in an account established by order of the Bankruptcy Court in an amount no less than \$50,000 (but not anticipated to be greater than \$65,000 at the time of payment), with NHMI obligated to otherwise satisfy obligations to its identified creditors up to \$48,000. The parties also agreed to extend the Appeal briefing period pending finalization of the settlement of the other actions, judgments and claims, as described below.

The Settlement Terms provide that, subject to payment of the amounts described above and satisfaction of certain other conditions, the parties will dismiss the California Action as to NHMI and the Kansas City Action and Delaware Judgment, effect notice of satisfaction of the Judgment, and effect a mutual release of all claims that were or could have been raised in any of the foregoing or that are related to the subject matter thereof, upon the earliest of the following: (i) July 1, 2010, (ii) a waiver by Wachovia of Wachovia's right to file an involuntary bankruptcy proceeding against any of the NovaStar Entities prior to

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July 1, 2010, (iii) an extension of the maturity date of NFI's indebtedness to Wachovia until at least July 1, 2010, or (iv) delivery to Plaintiff of written documentation evidencing the full satisfaction of NFI's current indebtedness to Wachovia.

In addition to the initial payments to be made to the Plaintiff following dismissal of the Involuntary, NFI will pay Plaintiff \$5.5 million if, prior to July 1, 2010, (i) NFI's average common stock market capitalization is at least \$94.4 million over a period of five (5) consecutive business days, or (ii) the holders of NFI's common stock are paid \$94.4 in net asset value as a result of any sale of NFI or its assets. If NFI is sold prior to July 1, 2010 for less than \$94.4 million and ceases to be a public company, then NFI will obligate the purchaser either to immediately pay \$2 million to Plaintiff, or to pay Plaintiff \$5.5 million in the event the value of the company exceeds \$94.4 million prior to July 1, 2010 as determined by an independent valuation company.

NFI makes no assurances with regard to its ability to satisfy any of the conditions described or referenced herein. Without limiting the foregoing, NFI has obtained no commitment from Wachovia with regard to any action that may be required of Wachovia in order to effect, prior to July 1, 2010, the dismissals and releases described above. Nothing herein or in the Settlement Terms should be construed as a belief, projection, assumption, or indication of intent of NFI or its management regarding any future event, any industry or market conditions, or NFI's financial condition, stock price, or business plans or strategies. Information concerning NFI, including without limitation, NFI's assets and results of operations, its business plans and strategies, and its financing arrangements with Wachovia, is contained in NFI's periodic filings with the Securities and Exchange Commission (the "SEC").

Statements in this report regarding NFI and its subsidiaries 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 and that do not relate solely to historical matters and include statements regarding management's future plans. Words such as "expect," "plan," and other expressions or words of similar meanings, as well as future or conditional verbs such as "will," "would," "should," "could," or "may" are generally intended to identify forward-looking statements. Actual results or events may vary materially from those discussed herein. Some important factors that could cause actual results or events to differ materially from those anticipated include: our ability to continue as a going concern and avoid seeking the protection of applicable bankruptcy laws; our ability to generate positive cash flow; our ability to reduce expenses from our discontinued operations; increases in the credit losses on mortgage loans held in our portfolio or underlying our mortgage securities; our ability to repay all amounts owed to Wachovia in a manner and time period

acceptable to Wachovia; our ability to obtain necessary waivers of, or amendments to, the documents governing our indebtedness; increases in prepayment or default rates on our mortgage assets; and the risks that are from time to time included in our filings with the SEC. Other factors not presently identified may also cause actual results to differ. This report on Form 8-K speaks only as of its date and we expressly disclaim any duty to update the information herein except as required by federal securities laws.

SIGNATURE

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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 hereunto duly authorized.

NOVASTAR FINANCIAL, INC.

DATE: March 20, 2008

/s/ Rodney Schwatken

Rodney Schwatken
Chief Financial Officer