

**UNITED STATES DISTRICT COURT  
FOR THE WESTERN DISTRICT OF MISSOURI  
WESTERN DIVISION**

\_\_\_\_\_  
IN RE NOVASTAR FINANCIAL, INC.  
SECURITIES LITIGATION  
\_\_\_\_\_

)  
) Case No. 04-0330-CV-W-ODS  
)

**NOTICE OF PENDENCY OF CLASS ACTION AND PROPOSED SETTLEMENT, MOTION FOR  
ATTORNEYS' FEES AND SETTLEMENT FAIRNESS HEARING**

**If you (1) purchased or otherwise acquired the common stock of NovaStar Financial, Inc. (“NovaStar”) during the period from October 29, 2003 through April 8, 2004, inclusive (the “Class Period”) and still held those shares as of April 8, 2004, or (2) sold NovaStar put options during the Class Period whose option extended beyond, and was exercised after, April 8, 2004, and (3) were damaged thereby, then you could get a payment from a class action settlement.**

*A federal court authorized this notice. This is not a solicitation from a lawyer.*

- The settlement will provide a \$7.25 million settlement fund for the benefit of a Class of purchasers of NovaStar common stock and sellers of NovaStar put options during the period from October 29, 2003 through April 8, 2004, inclusive.
- The settlement resolves a lawsuit over whether NovaStar and the Individual Defendants, who were controlling officers and/or directors of NovaStar, made materially false and misleading statements and omissions in NovaStar’s public reports and documents disseminated to the investing public, thereby artificially inflating the price of the securities of NovaStar and damaging members of the Class.
- Your legal rights are affected whether you act or do not act. Read this notice carefully.

<b>YOUR LEGAL RIGHTS AND OPTIONS IN THIS SETTLEMENT:</b>	
<b>SUBMIT A CLAIM FORM BY MAY 15, 2009</b>	The only way to get a payment.
<b>EXCLUDE YOURSELF BY MARCH 9, 2009</b>	Get no payment. This is the only option that allows you to ever be part of any other lawsuit against the Defendants and the other Released Parties about the Settled Claims.
<b>OBJECT BY MARCH 9, 2009</b>	Write to the Court about why you do not like the settlement.
<b>GO TO A HEARING ON APRIL 14, 2009 AT 9:00 A.M.</b>	Ask to speak in Court about the settlement.
<b>DO NOTHING</b>	Get no payment. Give up rights.

- These rights and options - **and the deadlines to exercise them** - are explained in this notice.
- The Court in charge of this case still has to decide whether to approve the settlement. Payments will be made if the Court approves the settlement and after appeals are resolved. Please be patient.

## SUMMARY NOTICE

### Statement of Plaintiff Recovery

Pursuant to the settlement described herein, a Settlement Fund consisting of \$7.25 million in cash, plus interest, has been established. Plaintiffs estimate that there were approximately 13.8 million shares of NovaStar common stock traded during the Class Period which may have been damaged. Plaintiffs estimate that the average recovery per damaged share of NovaStar common stock under the settlement is approximately 52.5¢ per damaged share<sup>1</sup> before deduction of Court-awarded attorneys' fees and expenses. Class Members who sold put options on NovaStar common stock may also receive payment from the Settlement Fund, but the various terms of those options and available records concerning such option transactions do not permit a useful estimate of the number of affected options or the recovery per option on those option transactions. A Class Member's actual recovery will be a proportion of the Net Settlement Fund determined by that claimant's Recognized Claim as compared to the total Recognized Claims of all Class Members who submit acceptable Proofs of Claim. Depending on the number of claims submitted, when during the Class Period a Class Member purchased shares of NovaStar common stock or sold NovaStar put options, the purchase price paid, and whether those shares or options were held at the end of the Class Period or sold during the Class Period, and, if sold, when they were sold and the amount received, an individual Class Member may receive more or less than this average amount. See the Plan of Allocation beginning on page 10 for more information on your Recognized Claim.

### Statement of Potential Outcome of Case

The parties disagree on both liability and damages and do not agree on the average amount of damages per share that would be recoverable if Plaintiffs were to have prevailed on each claim alleged. The issues on which the parties disagree include (a) the appropriate economic model for determining the amounts by which NovaStar common stock and NovaStar put options were allegedly artificially inflated (if at all) during the Class Period; (b) the amounts by which NovaStar common stock and NovaStar put options were allegedly artificially inflated (if at all) during the Class Period; (c) the effect of various market forces influencing the trading prices of NovaStar common stock and NovaStar put options at various times during the Class Period; (d) the extent to which external factors, such as general market and industry conditions, influenced the trading prices of NovaStar common stock and NovaStar put options at various times during the Class Period; (e) the extent to which the various matters that Plaintiffs alleged were materially false or misleading influenced (if at all) the trading prices of NovaStar common stock and NovaStar put options at various times during the Class Period; (f) the extent to which the various allegedly adverse material facts that Plaintiffs alleged were omitted influenced (if at all) the trading prices of NovaStar common stock and NovaStar put options at various times during the Class Period; and (g) whether the statements made or facts allegedly omitted were material or otherwise actionable under the federal securities laws. The Defendants deny that they are liable to Plaintiffs or the Class and deny that Plaintiffs or the Class have suffered any damages.

### Statement of Attorneys' Fees and Costs Sought

Plaintiffs' Counsel are moving the Court to award attorneys' fees not to exceed one-third (33⅓%) of the Gross Settlement Fund, and for reimbursement of expenses incurred in connection with the prosecution of this Action in the approximate amount of \$300,000. The requested fees and expenses would amount to an average of approximately 19.6¢ per damaged share in total for fees and expenses. Application will also be made for reimbursement to Class Representatives Generic Trading of Philadelphia, LLC and Harrold Daniels for an amount not to exceed \$30,000 in total for reimbursement of their reasonable costs and expenses (including lost wages) directly relating to their representation of the Class. Plaintiffs' Counsel have expended considerable time and effort in the prosecution of this litigation on a contingent fee basis, and have advanced the expenses of the litigation, in the expectation that if they were successful in obtaining a recovery for the Class they would be paid from such recovery. In this type of litigation it is customary for counsel to be awarded a percentage of the common fund recovery as their attorneys' fees.

### Further Information

Further information regarding the Action and this Notice may be obtained by contacting Plaintiffs' Co-Lead Counsel: Vincent R. Cappucci, Esq., Entwistle & Cappucci LLP, 280 Park Avenue, 26th Floor West, New York, NY 10017, Telephone (212) 894-7200; or Richard H. Weiss, Esq., Milberg LLP, One Penn Plaza, New York, NY 10119-0165, Telephone (212) 594-5300.

### Reasons for the Settlement

For the Plaintiffs, the principal reason for the settlement is the benefit to be provided to the Class now. This benefit must be compared to the risk that no recovery might be achieved after a contested trial and likely appeals, possibly years into the future, and to the attendant risks of continued litigation and of the inability of the Defendants to satisfy a judgment greater than the settlement amount, particularly in light of NovaStar's difficult financial condition.

For the Defendants, who deny all allegations of wrongdoing or liability whatsoever, the principal reason for the settlement is to eliminate the expense, risks, and uncertain outcome of the litigation.

**[END OF COVER PAGE]**

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<sup>1</sup> An allegedly damaged share might have been traded more than once during the Class Period, and the indicated average recovery would be the total for all purchasers of that share.

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## BASIC INFORMATION

### 1. Why did I get this notice package?

You or someone in your family may have purchased or otherwise acquired shares of NovaStar common stock or sold NovaStar put options during the period from October 29, 2003 through April 8, 2004, inclusive, and been damaged thereby.

The Court directed that this Notice be sent to Class Members because they have a right to know about a proposed settlement of a class action lawsuit, and about all of their options, before the Court decides whether to approve the settlement. If the Court approves the settlement, and after objections and appeals are resolved, an administrator appointed by the Court will make the payments that the settlement allows.

This package explains the lawsuit, the settlement, Class Members' legal rights, what benefits are available, who is eligible for them, and how to get them.

The Court in charge of the case is the United States District Court for the Western District of Missouri, and the case is known as *In re NovaStar Financial, Inc. Securities Litigation*, Case No. 04-0330-CV-W-ODS. This case was assigned to United States District Judge Ortrie D. Smith. The people who sued are called plaintiffs, and the company and the persons they sued, are called the Defendants.

The Defendants in this case are NovaStar and Individual Defendants Scott F. Hartman (NovaStar's co-founder and its CEO and Chairman of the Board during the Class Period), W. Lance Anderson (NovaStar's co-founder and its President, CFO and a director during the Class Period), and Rodney E. Schwatken (NovaStar's Vice President, Treasurer, and Controller (Principal Financial Officer) during the Class Period).

### 2. What is this lawsuit about?

During the Class Period, NovaStar was a real estate investment trust (REIT) engaged primarily in the business of residential "sub prime" lending. On April 13, 2004, this securities fraud class action was filed against NovaStar and the Individual Defendants on behalf of all injured investors who purchased NovaStar common stock or sold NovaStar put options between October 29, 2003 and April 8, 2004. The action alleged violations of sections 10(b) and 20(a) of the Securities Exchange Act of 1934.

Generic Trading of Philadelphia, LLC and Harrold and Wilma Daniels were designated Lead Plaintiffs pursuant to the Private Securities Litigation Reform Act of 1995 ("PSLRA") by Order of the Court on August 23, 2004.

By Order of the Court dated August 23, 2004, Entwistle & Cappucci LLP and Milberg Weiss Bershad & Schulman LLP (now known as Milberg LLP) were appointed as Co-Lead Counsel for the Class.

On November 12, 2004, Lead Plaintiffs filed their Consolidated Class Action Complaint (the "Complaint"). The Complaint alleges, among other things, that NovaStar and the Individual Defendants, who were controlling officers and/or directors of NovaStar, made materially false and misleading statements and omissions in NovaStar's public reports and documents disseminated to the investing public concerning, among other things, NovaStar's compliance with applicable regulatory requirements in certain states where it was doing business, thereby artificially inflating the price of the securities of NovaStar and damaging members of the Class.

The lawsuit seeks money damages against the Defendants for violations of the federal securities laws. The Defendants deny all allegations of misconduct contained in the Complaint, and deny having engaged in any wrongdoing whatsoever.

### 3. Why is this a class action?

In a class action, one or more people called Class Representatives (in this case Generic Trading of Philadelphia, LLC and Harrold Daniels), sue on behalf of people who have similar claims. All these people are a Class or Class Members. Bringing a case, such as this one, as a class action allows adjudication of many similar claims of persons and entities that might be economically too small to bring in individual actions. One court resolves the issues for all Class Members, except for those who exclude themselves from the Class.

### 4. Why is there a settlement?

On January 14, 2005, Defendants moved to dismiss the Complaint pursuant to the Private Securities Litigation Reform Act of 1995 and Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure. By Order and Opinion dated May 12, 2005, the Court denied the Defendants' motion to dismiss.

On June 27, 2005, Defendants answered the Complaint. The Defendants denied Plaintiffs' claims and asserted several defenses. In doing so, Defendants contend that they are not liable to Plaintiffs.

By Order and Opinion dated February 8, 2007, the Court granted Plaintiffs' motion for class certification. The Court's Order also certified Generic Trading of Philadelphia, LLC and Harrold Daniels as Class Representatives and appointed Entwistle & Cappucci LLP and Milberg Weiss Bershad & Schulman LLP (now known as Milberg LLP) as Co-Lead Counsel for the Class and Walters Bender Strohhahn & Vaughan, P.C. as Liaison Counsel for the Class.

By Order dated May 17, 2007, the Court denied Defendants' motion for reconsideration of the February 8, 2007 Order and Opinion and granted Plaintiffs' motion for clarification of the February 8, 2007 Order and Opinion.

On June 3, 2007, Defendants petitioned the U.S. Court of Appeals for the Eighth Circuit to permit an appeal from the District Court's order certifying the Class. On July 19, 2007, the Eighth Circuit denied Defendants' petition. Thereafter, Defendants sought rehearing or rehearing en banc, which was also denied.

Pursuant to formal pretrial discovery, Plaintiffs obtained from Defendants and various third parties approximately 135,000 pages of documents relating to matters at issue in the case, which Plaintiffs carefully reviewed and analyzed.

The Court did not finally decide in favor of Plaintiffs or Defendants. Instead, both sides, with the assistance of former Chief Magistrate Judge of the U.S. District Court, Northern District of California, Edward A. Infante of JAMS, acting as a mediator, agreed to a settlement. That way, they avoid the risks and cost of a trial, and the people affected will get compensation. The Class Representatives and their attorneys think the settlement is best for the Class.

## WHO IS IN THE SETTLEMENT

To see if you will get money from this settlement, you first have to decide if you are a Class Member.

### 5. How do I know if I am part of the settlement?

The Court decided that everyone who fits this description is a Class Member: *all persons who EITHER (1) purchased or otherwise acquired common stock of NovaStar Financial, Inc. ("NovaStar") during the period from October 29, 2003 through April 8, 2004, inclusive (the "Class Period") and still held shares of stock as of April 8, 2004, OR (2) sold NovaStar put options during the Class Period whose option extended beyond, and was exercised after, April 8, 2004, AND (3) as a result of NovaStar's actions, suffered damages.*

### 6. Are there exceptions to being included?

Excluded from the Class are the Defendants; the subsidiaries and affiliates of NovaStar; the officers and directors of NovaStar or its subsidiaries and affiliates, at all relevant times; members of the immediate family of any excluded person; the legal representatives, heirs, successors, and assigns of any excluded person; and any entity in which any excluded person has or had a controlling interest.

If one of your mutual funds purchased or otherwise acquired shares of NovaStar common stock or sold NovaStar put options during the Class Period, that alone does not make you a Class Member. You are a Class Member only if you directly purchased or otherwise acquired shares of NovaStar common stock or sold NovaStar put options during the Class Period. Check your investment records or contact your broker to see if you purchased or otherwise acquired shares of NovaStar common stock or sold NovaStar put options during the Class Period.

If you **sold** NovaStar common stock or **purchased** NovaStar put options during the Class Period, that alone does not make you a Class Member. You are a Class Member only if you **purchased or otherwise acquired** your shares of NovaStar common stock or **sold** NovaStar put options during the Class Period.

### 7. What if I am still not sure if I am included?

If you are still not sure whether you are included, you can ask for free help. You can call 1-877-556-8144 or visit [www.novastarsecuritieslitigation.com](http://www.novastarsecuritieslitigation.com) for more information. Or you can fill out and return the Proof of Claim form described on page 6, in question 10, to see if you qualify.

## THE SETTLEMENT BENEFITS — WHAT YOU GET

### 8. What does the settlement provide?

In exchange for the Settlement and dismissal of the Action, Defendants have agreed to create a \$7.25 million fund to be divided, after fees and expenses, among all Class Members who send in a valid Proof of Claim form.

### 9. How much will my payment be?

Your share of the fund will depend on the total Recognized Claims represented by the valid Proof of Claim forms that Class Members send in, how many shares of NovaStar common stock you bought and the number of NovaStar put options you sold, and when you bought and sold them.

You can calculate your Recognized Claim in accordance with the formula shown below in the Plan of Allocation. It is unlikely that you will get a payment for all of your Recognized Claim. After all Class Members have sent in their Proof of Claim forms, the payment you get will be a part of the Net Settlement Fund equal to your Recognized Claim divided by the total of everyone's Recognized Claims. See the Plan of Allocation beginning on page 10 for more information on your Recognized Claim.

## HOW YOU GET A PAYMENT — SUBMITTING A PROOF OF CLAIM FORM

### 10. How can I get a payment?

To qualify for a payment, you must send in a Proof of Claim form. A Proof of Claim form is being circulated with this Notice. You may also get a Proof of Claim form on the Internet at [www.novastarsecuritieslitigation.com](http://www.novastarsecuritieslitigation.com). Read the instructions carefully, fill out the Proof of Claim form, include all the documents the form asks for, sign it, and mail it postmarked no later than **May 15, 2009**.

### 11. When would I get my payment?

The Court will hold a hearing on **April 14, 2009**, to decide whether to approve the settlement. If the Court approves the settlement after that, there may be appeals. It is always uncertain whether these appeals can be resolved, and resolving them can take time, perhaps more than a year. It also takes time for all the Proofs of Claim to be processed. Please be patient.

### 12. What am I giving up to get a payment or stay in the Class?

Unless you exclude yourself, you are staying in the Class, and that means that, upon the "Effective Date," you will release all "Settled Claims" (as defined below) against the "Released Parties" (as defined below).

"Settled Claims" means any and all claims, debts, demands, rights or causes of action or liabilities whatsoever (including, but not limited to, any claims for damages, interest, attorneys' fees, expert or consulting fees, and any other costs, expenses or liability whatsoever), whether based on federal, state, local, statutory or common law or any other law, rule or regulation, whether fixed or contingent, accrued or un-accrued, liquidated or un-liquidated, at law or in equity, matured or un-matured, whether class or individual in nature, including both known claims and Unknown Claims, (i) that have been asserted in this Action by the Class Members or any of them against any of the Released Parties, or (ii) that could have been asserted in any forum by the Class Members or any of them against any of the Released Parties which arise out of or are based upon the allegations, transactions, facts, matters or occurrences, representations or omissions involved, set forth, or referred to in the Complaint and which relate to the purchase or acquisition of NovaStar common stock or to the sale of NovaStar put options during the Class Period. "Settled Claims" does not mean or include claims, if any, against the Released Parties arising under the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001, *et seq.* ("ERISA") that could be asserted by an individual Class Member or an ERISA Fiduciary in a capacity other than as a purchaser of NovaStar common stock (or seller of NovaStar put options) during the Class Period at prices allegedly artificially inflated (or deflated) by the misrepresentations or omissions alleged in the Action.

"Released Parties" means any and all of the Defendants, their past or present subsidiaries, parents, successors and predecessors, officers, directors, agents, employees, attorneys, advisors, investment advisors, auditors, insurers, accountants, and any person, firm, trust, corporation, officer, director or other individual or entity in which any Defendant has a controlling interest or which is related to or affiliated with any of the Defendants, and the legal representatives, heirs, successors in interest or assigns of the Defendants.

The “Effective Date” will occur when an Order entered by the Court approving the Settlement becomes final and not subject to appeal.

If you remain a member of the Class, all of the Court’s orders will apply to you and legally bind you.

### **EXCLUDING YOURSELF FROM THE SETTLEMENT**

If you do not want a payment from this settlement, but you want to keep any right you may have to sue or continue to sue the Defendants and the other Released Parties, on your own, about the Settled Claims, then you must take steps to get out. This is called excluding yourself — or is sometimes referred to as “opting out” of the settlement class. Defendants may withdraw from and terminate the Settlement if putative Class Members who purchased or otherwise acquired in excess of a certain amount of NovaStar common stock exclude themselves from the Class.

#### **13. How do I get out of the proposed settlement?**

To exclude yourself from the settlement Class, you must send a signed letter by mail stating that you “request exclusion from the Class in *In re NovaStar Financial, Inc. Securities Litigation*, Case No. 04-0330-CV-W-ODS.” Your letter should state the date(s), price(s), and number(s) of shares of all purchases, acquisitions, and sales of NovaStar common stock or put options during the Class Period. In addition, be sure to include your name, address, telephone number, and your signature. You must mail your exclusion request postmarked no later than **March 9, 2009** to:

In re NovaStar Financial, Inc. Securities Litigation EXCLUSIONS  
c/o Analytics Incorporated, Claims Administrator  
P.O. Box 2006  
Chanhassen, Minnesota 55317-2006

You cannot exclude yourself by telephone or by e-mail. If you ask to be excluded, you will not get any settlement payment, and you cannot object to the settlement. You will not be legally bound by anything that happens in this lawsuit, and you may be able to sue (or continue to sue) the Defendants and the other Released Parties in the future.

#### **14. If I do not exclude myself, can I sue the Defendants and the other Released Parties for the same thing later?**

No. Unless you exclude yourself, you give up any rights to sue the Defendants and the other Released Parties for any and all Settled Claims. If you have a pending lawsuit speak to your lawyer in that case immediately. You must exclude yourself from *this* Class to continue your own lawsuit. Remember, the exclusion deadline is **March 9, 2009**.

#### **15. If I exclude myself, can I get money from the proposed settlement?**

No. If you exclude yourself, do not send in a Proof of Claim form to ask for any money. But, you may exercise any right you may have to sue, continue to sue, or be part of a different lawsuit against the Defendants and the other Released Parties.

### **THE LAWYERS REPRESENTING THE CLASS**

#### **16. Do I have a lawyer in this case?**

The Court ordered that the law firms of Entwistle & Capucci LLP in New York, NY and of Milberg LLP in New York, NY will represent the Class. These lawyers are called Plaintiffs’ Co-Lead Counsel. You will not be separately charged for these lawyers. The Court will determine the amount of Plaintiffs’ Co-Lead Counsel’s fees and expenses, which will be paid from the Gross Settlement Fund. If you want to be represented by your own lawyer, you may hire one at your own expense.

#### **17. How will the lawyers be paid?**

Plaintiffs’ Co-Lead Counsel are moving the Court to award attorneys’ fees from the Gross Settlement Fund in an amount not to exceed one-third (33⅓%) of the Gross Settlement Fund and for reimbursement of their expenses in the approximate amount of \$300,000, plus interest on such expenses at the same rate as earned by the Settlement Fund.

The motion for attorneys’ fees and expenses will be submitted on behalf of Plaintiffs’ Co-Lead Counsel and the following additional Plaintiffs’ Counsel: Walters Bender Strohhahn & Vaughan, P.C., 2500 City Center Square, 1100 Main Street,

P.O. Box 26188, Kansas City, MO 64196; Chitwood Harley Harnes LLP, 2300 Promenade II, 1230 Peachtree Street, N.E., Atlanta, GA 30309; and The Brualdi Law Firm, 29 Broadway, New York, NY 10006.

Plaintiffs' Co-Lead Counsel are also moving the Court to award reimbursement payments to Class Representatives Generic Trading of Philadelphia, LLC and Harrold Daniels for an amount not to exceed \$30,000 in total for reimbursement of their reasonable costs and expenses (including lost wages) directly relating to their representation of the Class.

Plaintiffs' Co-Lead Counsel, without further notice to the Class, will subsequently apply to the Court for payment of the Claims Administrator's fees and expenses incurred in connection with giving notice, administering the settlement and distributing the settlement proceeds to the members of the Class.

## OBJECTING TO THE SETTLEMENT

You can tell the Court that you do not agree with the settlement or some part of it.

### 18. How do I tell the Court that I do not like the proposed settlement?

If you are a Class Member you can object to the Settlement or any of its terms, the proposed Plan of Allocation and/or the application by Plaintiffs' Co-Lead Counsel for an award of fees and expenses. You may write to the Court setting out your objection. You may give reasons why you think the Court should not approve any or all of the Settlement terms or arrangements. The Court will consider your views if you file a proper objection within the deadline identified, and according to the following procedures.

To object, you must send a signed letter stating that you object to the proposed settlement in the *In re NovaStar Financial, Inc. Securities Litigation*, Case No. 04-0330-CV-W-ODS. Be sure to include your name, address, telephone number, and your signature, identify the date(s), price(s), and number(s) of shares of all purchases, acquisitions, and sales of NovaStar common stock or put options you made during the Class Period, and state the reasons why you object to the Settlement. Your objection must be filed with the Court and served on all the following counsel on or before **March 9, 2009**:

#### COURT

Clerk of the Court  
United States District Court for the  
Western District of Missouri  
Charles Evans Whittaker Courthouse  
400 E. 9th Street  
Kansas City, MO 64106

#### PLAINTIFFS' CO-LEAD COUNSEL

Vincent R. Cappucci  
Entwistle & Cappucci LLP  
280 Park Avenue  
26th Floor West  
New York, NY 10017

Richard H. Weiss  
Milberg LLP  
One Penn Plaza  
New York, NY 10119-0165

#### DEFENDANTS' COUNSEL

William F. Alderman  
Orrick, Herrington & Sutcliffe LLP  
405 Howard Street  
San Francisco, CA 94105

You do not need to go to the Settlement Fairness Hearing to have your written objection considered by the Court. At the Settlement Fairness Hearing, any Class Member who has not previously submitted a request for exclusion from the Class and who has complied with the procedures set out in this question 18 and question 22 below for filing with the Court and providing to the counsel for Plaintiffs and Defendants a statement of an intention to appear at the Settlement Fairness Hearing may also appear and be heard, to the extent allowed by the Court, to state any objection to the Settlement, the Plan of Allocation or Plaintiffs' Co-Lead Counsel's motion for an award of attorneys' fees and reimbursement of expenses. Any such objector may appear in person or arrange, at that objector's expense, for a lawyer to represent the objector at the Hearing.

### 19. What is the difference between objecting and excluding?

Objecting is simply telling the Court that you do not like something about the proposed settlement. You can object only if you stay in the Class. Excluding yourself is telling the Court that you do not want to be part of the Class. If you exclude yourself, you have no basis to object because the case no longer affects you.

## THE COURT'S SETTLEMENT FAIRNESS HEARING

The Court will hold a hearing to decide whether to approve the proposed settlement. You may attend and you may ask to speak, but you do not have to.

### **20. When and where will the Court decide whether to approve the proposed settlement?**

The Court will hold a Settlement Fairness Hearing at **9:00 a.m. on Tuesday, April 14, 2009**, at the United States District Court for the Western District of Missouri, Charles Evans Whittaker Courthouse, 400 E. 9th Street, Kansas City, Missouri 64106. At this hearing the Court will consider whether the settlement is fair, reasonable and adequate. At the Settlement Fairness Hearing, the Court also will consider the proposed Plan of Allocation for the proceeds of the Settlement and the application of Plaintiffs' Co-Lead Counsel for attorneys' fees and reimbursement of expenses. The Court will take into consideration any written objections filed in accordance with the instructions at question 18. The Court also may listen to people who have properly indicated, within the deadline identified above, an intention to speak at the hearing; but decisions regarding the conduct of the hearing will be made by the Court. See question 22 for more information about speaking at the hearing. The Court may also decide how much to pay to Plaintiffs' Counsel. After the hearing, the Court will decide whether to approve the settlement. We do not know how long these decisions will take.

You should be aware that the Court may change the date and time of the Settlement Fairness Hearing. Thus, if you want to come to the hearing, you should check with Plaintiffs' Co-Lead Counsel before coming to be sure that the date and/or time has not changed.

### **21. Do I have to come to the hearing?**

No. Plaintiffs' Counsel will answer questions the Court may have. But, you are welcome to come at your own expense. If you send an objection, you do not have to come to Court to talk about it. As long as you filed your written objection on time, the Court will consider it. You may also pay your own lawyer to attend, but it is not necessary. Class Members do not need to appear at the hearing or take any other action to indicate their approval.

### **22. May I speak at the hearing?**

If you object to the Settlement, you may ask the Court for permission to speak at the Settlement Fairness Hearing. To do so, you must include with your objection (see question 18 above) a statement stating that it is your "Notice of Intention to Appear in *In re NovaStar Financial, Inc. Securities Litigation*, Case No. 04-0330-CV-W-ODS" Persons who intend to object to the Settlement, the Plan of Allocation, and/or counsel's application for an award of attorneys' fees and expenses and desire to present evidence at the Settlement Fairness Hearing must include in their written objections the identity of any witnesses they may call to testify and exhibits they intend to introduce into evidence at the Settlement Fairness Hearing. Unless otherwise ordered by the Court, you cannot speak at the hearing if you excluded yourself from the Class or if you have not provided written notice of your intention to speak at the Settlement Fairness Hearing by the deadline identified, and in accordance with the procedures described in questions 18 and 20 above.

## IF YOU DO NOTHING

### **23. What happens if I do nothing at all?**

If you do nothing, you will get no money from this settlement and you will be precluded from starting a lawsuit, continuing with a lawsuit, or being part of any other lawsuit against Defendants and the other Released Parties about the Settled Claims in this case, ever again. To share in the Net Settlement Fund you must submit a Proof of Claim form (see question 10). To start, continue or be a part of any other lawsuit against the Defendants and the other Released Parties about the Settled Claims in this case you must exclude yourself from this Class (see question 13).

## GETTING MORE INFORMATION

### **24. Are there more details about the proposed settlement?**

This notice summarizes the proposed settlement. More details are in a Stipulation and Agreement of Settlement dated December 3, 2008 (the "Stipulation"). You can get a copy of the Stipulation by writing to Vincent R. Cappucci, Esq., Entwistle & Cappucci LLP, 280 Park Avenue, 26th Floor West, New York, NY 10017 or Richard H. Weiss, Esq., Milberg LLP, One Penn Plaza, New York, NY 10119-0165, or by visiting [www.novastarsecuritieslitigation.com](http://www.novastarsecuritieslitigation.com).

You also can call the Claims Administrator at 1-877-556-8144 toll free; write to

In re NovaStar Financial, Inc. Securities Litigation  
c/o Analytics Incorporated, Claims Administrator  
P.O. Box 2006  
Chanhassen, MN 55317-2006

or visit the website at [www.novastarsecuritieslitigation.com](http://www.novastarsecuritieslitigation.com), where you will find answers to common questions about the Settlement, a Proof of Claim form, plus other information to help you determine whether you are a Class Member and whether you are eligible for a payment.

## 25. How do I get more information?

For even more detailed information concerning the matters involved in this Action, you may refer to the pleadings, to the Stipulation, to the Orders entered by the Court and to the other papers filed in the Action, which may be inspected at the Office of the Clerk of the United States District Court for the Western District of Missouri, Charles Evans Whittaker Courthouse, 400 E. 9th Street, Kansas City, Missouri 64106, during regular business hours.

### PLAN OF ALLOCATION OF NET SETTLEMENT FUND AMONG CLASS MEMBERS

The \$7.25 million Cash Settlement Amount and the interest earned thereon shall be the Gross Settlement Fund. The Gross Settlement Fund, less all taxes, approved costs, fees and expenses (the “Net Settlement Fund”) shall be distributed to members of the Class who submit acceptable Proofs of Claim (“Authorized Claimants”).

The Claims Administrator shall determine each Authorized Claimant’s *pro rata* share of the Net Settlement Fund based upon each Authorized Claimant’s “Recognized Claim.” The Recognized Claim formula is not intended to be an estimate of the amount of what a Class Member might have been able to recover after a trial; nor is it an estimate of the amount that will be paid to Authorized Claimants pursuant to the settlement. The Recognized Claim formula is the basis upon which the Net Settlement Fund will be proportionately allocated to the Authorized Claimants.

The following proposed Plan of Allocation reflects plaintiffs’ allegations that the price of NovaStar common stock was inflated artificially during the period from October 29, 2003 through April 8, 2004, inclusive (the “Class Period”) due to misrepresentations regarding NovaStar’s regulatory compliance, success, and the size of the NovaStar’s branch network, and NovaStar’s failure and omission to disclose that Massachusetts and Nevada both shut down NovaStar’s operations in their states for regulatory violations. Upon the revelations made about NovaStar’s regulatory compliance problems in an article in *The Wall Street Journal* on Monday, April 12, 2004 the price of NovaStar common stock plummeted precipitously, closing at \$37.50 per share on April 12, 2004 (the first trading day after the end of the Class Period), down from the closing price of \$54.18 per share on April 8, 2004 (the last trading day before the disclosure) -- a one day drop of \$16.68 per share. Other than the article from *The Wall Street Journal* discussed above, no other news or events concerning NovaStar were announced that day. During the 90 day period following the disclosures, the price of NovaStar’s shares began to rebound and closed at \$42.15 on July 7, 2004.

“Recognized Claim” will be calculated for purposes of the Settlement as follows:

#### Common Stock Purchases:

- (1) For shares of NovaStar common stock purchased during the period from October 29, 2003 through April 8, 2004, inclusive, and
  - (a) Sold on or before the close of trading on April 8, 2004, an Authorized Claimant shall have no (\$0.00) “Recognized Claim”;
  - (b) Sold at a loss during the period April 12, 2004 through and including July 7, 2004, an Authorized Claimant’s “Recognized Claim” shall mean **the lesser of:** (a) \$16.68 per share, **or** (b) the purchase price paid (including commissions, etc.) (the “PPP”) less the sales proceeds received (net of commissions, etc.) (the “SPR”);
  - (c) Held after the close of trading on July 7, 2004, an Authorized Claimant’s “Recognized Claim” shall mean **the lesser of:** (a) \$16.68 per share, **or** (b) the PPP less \$42.15 per share.

### **Put Option Sales:**

- (1) No claim will be recognized for any NovaStar put options sold (written) during the Class Period that were not the open, unexpired obligation of the claimant as of the close of trading on April 8, 2004.
- (2) For NovaStar Put Options sold (written) during the Class Period, which were the open unexpired obligation of the Authorized Claimant at the close of trading on April 8, 2004, an Authorized Claimant's "Recognized Claim" shall be **the lesser of:** (a) of the difference, if a loss, between (x) the amount received for writing the put options during the Class Period (net of brokerage commissions and transaction charges) (the "SPR") and (y) the sum for which said put options were re-purchased at a loss<sup>2</sup> (including brokerage commissions and transaction charges) (the "PPP"); **or** (b) \$16.68 per share covered by such Put Option contracts.
- (3) For NovaStar Put Options written during the Class Period that were "put" to the Authorized Claimant (i.e. exercised) (whether before or after the close of trading on April 8, 2004), the Authorized Claimant's "Recognized Claim" shall be calculated as a purchase of common stock as shown above, and as if the sale of the Put Option were instead a purchase of NovaStar common stock on the date of the sale of the Put Option, and the "purchase price paid" shall be the strike price less the proceeds received on the sale of the Put Option.
- (4) No loss shall be Recognized based on a sale of any Put Option that was previously purchased.

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To the extent a Claimant had a gain from his, her or its overall transactions in NovaStar common stock or put options during the Class Period, the value of the Recognized Claim will be zero. To the extent that a Claimant suffered an overall loss on his, her or its overall transactions in NovaStar common stock or put options during the Class Period, but that loss was less than the Recognized Claim calculated above, then the Recognized Claim shall be limited to the amount of the actual loss.

For purposes of determining whether a Claimant had a gain from his, her or its overall transactions in NovaStar common stock or put options during the Class Period or suffered a loss, the Claims Administrator shall: (i) total the amount paid for all NovaStar common stock or put options purchased during the Class Period by the claimant (the "Total Purchase Amount"); (ii) match any sales of NovaStar common stock or put options during the Class Period first against the Claimant's opening position in the securities (the proceeds of those sales will not be considered for purposes of calculating gains or losses); (iii) total the amount received for sales of the remaining NovaStar common stock or put options sold during the Class Period (the "Sales Proceeds"); (iv) ascribe a \$37.50 per share holding value for the number of shares of NovaStar common stock purchased during the Class Period and still held at the end of the Class Period, and subtract the in-the-money liability of any put obligations that were the open obligation of the claimant at the close of trading on April 8, 2004 ("Holding Value"). The difference between (x) the Total Purchase Amount and the (y) sum of the Sales Proceeds and Holding Value, will be deemed a Claimant's gain or loss on his, her or its overall transactions in NovaStar common stock during the Class Period.

Each Authorized Claimant shall be allocated a *pro rata* share of the Net Settlement Fund based on his, her or its Recognized Claim as compared to the total Recognized Claims of all Authorized Claimants. The minimum distribution amount to an Authorized Claimant with a valid Recognized Claim shall be \$10.00.

Class Members who do not submit acceptable Proofs of Claim will not share in the settlement proceeds. Class Members who do not either submit a request for exclusion or submit an acceptable Proof of Claim will nevertheless be bound by the settlement and the Order and Final Judgment of the Court dismissing this Action.

Distributions will be made to Authorized Claimants after all claims have been processed and after the Court has finally approved the settlement. If any funds remain in the Net Settlement Fund by reason of un-cashed payments or otherwise, then, after the Claims Administrator has made reasonable and diligent efforts to have Class Members who are entitled to participate in the distribution of the Net Settlement Fund cash their distributions, any balance remaining in the Net Settlement Fund one (1) year after the initial distribution of such funds shall be re-distributed to Class Members who have cashed their initial distributions and who would receive at least \$10.00 from such re-distribution, after payment of any unpaid costs or fees incurred in administering the Net Settlement Fund for such re-distribution. If after six months after such re-distribution any funds shall remain in the Net Settlement Fund, then such balance shall be contributed to non-sectarian, not-for-profit, 501(c)(3) organization(s) designated by Plaintiffs' Co-Lead Counsel.

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<sup>2</sup> For NovaStar put options sold (written) during the Class Period that expired unexercised, an Authorized Claimant's "Recognized Claim" shall be \$0.00.

## SPECIAL NOTICE TO SECURITIES BROKERS AND OTHER NOMINEES

If you purchased or otherwise acquired NovaStar Financial, Inc. common stock<sup>3</sup> or sold NovaStar put options between October 29, 2003 and April 8, 2004, inclusive, for the beneficial interest of a person or entity other than yourself, the Court has directed that, WITHIN SEVEN (7) DAYS OF YOUR RECEIPT OF THIS NOTICE, you either (a) provide to the Claims Administrator the name and last known address of each person or entity for whom or which you purchased NovaStar common stock or sold NovaStar put options during such time period or (b) request additional copies of this Notice and the Proof of Claim form, which will be provided to you free of charge, and within seven (7) days mail the Notice and Proof of Claim form directly to the beneficial owners of those NovaStar common shares and put options. If you choose to follow alternative procedure (b), the Court has directed that, upon such mailing, you send a statement to the Claims Administrator confirming that the mailing was made as directed. You are entitled to reimbursement from the Settlement Fund of your reasonable expenses actually incurred in connection with the foregoing, including reimbursement of postage expense and the cost of ascertaining the names and addresses of beneficial owners. Those expenses will be paid upon request and submission of appropriate supporting documentation. All communications concerning the foregoing should be addressed to the Claims Administrator:

In re NovaStar Financial, Inc. Securities Litigation  
c/o Analytics Incorporated, Claims Administrator  
P.O. Box 2006  
Chanhassen, Minnesota 55317-2006

1-877-556-8144

[www.novastarsecuritieslitigation.com](http://www.novastarsecuritieslitigation.com)

IT IS SO ORDERED.

/s/ Ortrie D. Smith  
ORTRIE D. SMITH, JUDGE  
UNITED STATES DISTRICT COURT

DATE: December 15, 2008

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<sup>3</sup> NovaStar common stock traded on the New York Stock Exchange during the Class Period under the ticker symbol NFI; CUSIP 669947400. NovaStar put options traded on the Chicago Board Options Exchange, the American Stock Exchange, and the Pacific Stock Exchange throughout the Class Period and on the Philadelphia Stock Exchange from November 26, 2003 onward.