

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2019

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 0-14938

HG HOLDINGS, INC.

(Exact name of Registrant as specified in its Charter)

Delaware

(State or other jurisdiction of incorporation or organization)

54-1272589

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

2115 E. 7th Street, Suite 101, Charlotte, North Carolina 28204

(Address of principal executive offices, Zip Code)

Registrant's telephone number, including area code: (252) 355-4610

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$.02 per share, Preferred Stock Purchase Rights

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

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

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

Indicate by check mark whether the Registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.504 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit such files): Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act, (check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

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

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

Aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant based on the closing price on July 1, 2019: \$9.1 million.

Indicate the number of shares outstanding of each of the Registrant's classes of common stock as of March 12, 2020:

<u>Common Stock, par value \$.02 per share</u>	<u>14,946,839</u>
(Class of Common Stock)	Number of Shares

Documents incorporated by reference: Portions of the Registrant's Proxy Statement for our 2020 Annual Meeting of Stockholders are incorporated by reference into Part III.

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PART I

Item 1. Business

General

We were incorporated in Delaware in 1984. Until March 2, 2018, we were a leading design, marketing and distribution resource in the upscale segment of the wood residential furniture market. On March 2, 2018, we sold substantially all our assets and changed our name to HG Holdings, Inc. In this Annual Report of Form 10-K, we sometimes refer to HG Holdings, Inc. as the “Company.”

Asset Sale

On March 2, 2018, we sold substantially all of our assets (the “Asset Sale”) to Stanley Furniture Company LLC, formerly Churchill Downs LLC (“Buyer”), pursuant to the terms of the Asset Purchase Agreement, dated as of November 20, 2017, as amended by the First Amendment thereto dated January 22, 2018 (the “Asset Purchase Agreement”). Operations of the furniture business from January 1, 2018 through March 2, 2018 are reflected as discontinued operations pursuant to the provisions of Accounting Standards Codification 2015-20, *Presentation of Financial Statements – Discontinued Operations* for all periods presented.

As consideration for the Asset Sale, Buyer paid a purchase price consisting of cash in the amount of approximately \$10.8 million (of which approximately \$1.3 million was used to pay the outstanding amount under our credit agreement), a subordinated secured promissory note in the principal amount of approximately \$7.4 million (the “Original Note”), and a 5% equity interest in Buyer’s post-closing ultimate parent company, Churchill Downs Holdings, Ltd., a British Virgin Islands business company. At the closing of the Asset Sale, Buyer acquired approximately \$193,000 of cash that was on the Company’s balance sheet, resulting in the Company recording net cash received of approximately \$10.6 million from the Asset Sale. The Buyer also assumed substantially all of our liabilities.

Pursuant to a stock purchase agreement dated February 7, 2019, Buyer’s British Virgin Island parent company repurchased 2,500 shares of its stock held by the Company. The Company no longer maintains an equity interest in Buyer’s British Virgin Island parent company.

Stone & Leigh Asset Sale

On September 6, 2018, the Buyer sold certain of its assets, including certain inventory and the Stone & Leigh tradename (the “S&L Asset Sale”) to Stone & Leigh, LLC (“S&L”), which is owned by a group which includes Matthew W. Smith, the Company’s former interim Chief Executive Officer. As a part of the S&L Asset Sale, the Buyer assigned to S&L certain of its rights and obligations under the Original Note issued to the Company in March 2018 as partial consideration for the Asset Sale. In connection with the assignment, the Company entered into an Amended and Restated Subordinated Secured promissory note with the Buyer (the “A&R Note”) with a principal amount as of the assignment date of \$3.3 million and a new Subordinated Secured Promissory Note with S&L (the “S&L Note”) with a principal amount of \$4.4 million as of the assignment date. For further information on the A&R Note and S&L Note, see Note 4 of the Notes to Consolidated Financial Statements in Item 1.

Acquisition of Equity Interest in HC Government Realty Trust, Inc.

The Company has acquired an equity interest in HC Government Realty Trust, Inc., a Maryland corporation (“HC Realty”). HC Realty currently owns and operates a portfolio of 20 single-tenant properties leased entirely to the United States of America for occupancy by federal agencies including the Federal Bureau of Investigation, the Drug Enforcement Administration, the Social Security Administration and the Department of Transportation.

On March 19, 2019, we purchased 300,000 shares of HC Realty’s Common Stock (the “HC Common Stock”) for an aggregate purchase price of \$3,000,000 and 200,000 shares of HC Realty’s 10.00% Series B Cumulative Convertible Preferred Stock (the “HC Series B Stock”) for an aggregate purchase price of \$2,000,000. As a result of these purchases, we currently own approximately 16.4% of the as-converted equity interest of HC Realty; however, we do not control HC Realty as a result of our current ownership interest.

Certain other investors, including certain investors affiliated with Hale Partnership Capital Management, LLC (“HPCM”), purchased an additional 850,000 shares of Series B Stock for an aggregate purchase price of \$8,500,000 on March 19, 2019.

On March 19, 2019, we, together with certain other lenders, including certain entities affiliated with HPCM (collectively, the “Lenders”), entered into a loan agreement (the “Loan Agreement”) with HC Realty’s operating partnership, and HCM Agency, LLC, as collateral agent (the “Agent”), pursuant to which the Lenders provided HC Realty’s operating partnership with a \$10,500,000 senior secured term loan (the “Initial Term Loan”), of which \$2,000,000 was provided by us. The Agent is affiliated with HPCM.

In connection with the transactions discussed above, Steven A. Hale II, our Chairman and Chief Executive Officer, was appointed to serve as HC Realty’s Chairman and Chief Executive Officer. In addition, Mr. Hale, Brad G. Garner, our Principal Financial and Accounting Officer, and Matthew A. Hultquist, one of our directors, were each appointed to serve as directors of HC Realty. HC Realty’s Board of Directors is composed of seven directors with two positions currently vacant.

Additional information on HC Common Stock, HC Series B Stock, the Loan Agreement and HC Realty is disclosed in the Annex D in the prospectus included in our Registration Statement (No. 333-235539) on Form S-1 as amended, which Annex D is incorporated herein by reference.

Forward-Looking Statements

Certain statements made in this report are not based on historical facts, but are forward-looking statements. These statements can be identified by the use of forward-looking terminology such as “believes,” “estimates,” “expects,” “may,” “will,” “should,” “could,” or “anticipates,” or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy. These statements reflect our reasonable judgment with respect to future events and are subject to risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Such risks and uncertainties include the occurrence of events that negatively impact the Company’s liquidity in such a way as to limit or eliminate the Company’s ability to use proceeds from the Asset Sale to fund asset acquisitions, an inability on the part of the Company to identify a suitable business to acquire or develop with the proceeds of the Asset Sale, and the occurrence of events that negatively impact the business or assets of HC Realty and the value of our investment in HC Realty. Any forward-looking statement speaks only as of the date of this filing and we undertake no obligation to update or revise any forward-looking statements, whether as a result of new developments or otherwise.

No assurance can be given that the actual future results will not differ materially from the forward looking statements that we make for a number of reasons including those described above and in Item IA. Risk Factors below.

Available Information

Our principal Internet address is www.hgholdingsinc.net. We make available free of charge on this web site our annual, quarterly and current reports, and amendments to those reports, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

In addition, you may request a copy of these filings (excluding exhibits) at no cost by writing, telephoning or e-mailing us at the following address, telephone number or e-mail address:

HG Holdings, Inc.
2115 E. 7th Street, Suite 101
Charlotte, North Carolina 28204
Attention: Mr. Brad G. Garner
Telephone: 252-355-4610

Or e-mail your request to: investor@hgholdingsinc.net

Item 1A. Risk Factors

An investment in our common stock involves a high degree of risk. You should consider carefully the specific risk factors described below in addition to the other information contained in this Annual Report on Form 10-K, including our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K, before making a decision to invest in our common stock. If any of these risks actually occurs, our business, financial condition, results of operations or prospects could be materially and adversely affected. This could cause the trading price of our common stock to decline and a loss of all or part of your investment.

We have no revenue-generating operations owned directly by the Company and have limited sources of income following the Asset Sale, which may negatively impact the value and liquidity of our common stock.

As a result of the Asset Sale, we had no revenue-generating operations and no sources of income other than payments of interest and principal under the subordinated secured promissory notes from Buyer and S&L, then remaining payments to be made to us under the Continued Dumping and Subsidy Offset Act, refundable alternative minimum tax credits, and repayment at death of premiums we have paid for a split dollar life insurance policy for a former executive officer. As of March 19, 2019, our sources of income also include dividends on HC Common Stock and HC Series B Stock and interest paid on the loan we made to HC Realty's operating partnership. There can be no guarantee that suitable assets in addition to our investment in HC Realty will be available for us to purchase or that any assets acquired will generate the revenues anticipated or any revenue at all. A failure by us to secure additional sources of revenue could negatively impact the value and liquidity of our common stock.

We may not receive the amount owed us under the subordinated secured promissory notes from Buyer and S&L.

Our promissory note from Buyer originally matured with the entire principal amount payable on the date that is five years after the closing of the Asset Sale. Buyer's obligations under this note, including its payment obligations, and our rights and remedies with respect to the collateral pledged by Buyer under this note may at times be subordinate to Buyer's obligations under, and the lender's rights with respect to, Buyer's senior secured loan facility, including the lender's rights to the collateral pledged by Buyer in connection with its senior secured loan facility. As a result, there can be no guarantee that Buyer will pay us any portion of the interest or principal due under this note or that upon any default by Buyer we will have access to any of the collateral pledged by Buyer under this note. Our collateral pledged by Buyer under our promissory note from Buyer was not subordinated as of December 31, 2019. On October 31, 2019, the Company entered into a Forbearance Agreement (the "Forbearance Agreement") with the Buyer pursuant to which the Company has agreed to forbear from exercising its rights and remedies under Note until February 24, 2020 or earlier in the event of (i) a default or (ii) breach of the Forbearance Agreement by the Buyer. The Forbearance agreement was amended to extend the outside termination date from February 24, 2020 to February 26, 2020, when the forbearance period terminated, and again until March 17, 2020.

The S&L Note will mature, and the entire principal amount will be payable on, the date that is five years after the closing of the Asset Sale. S&L's obligations under this note, including its principal payment obligations, and our rights and remedies with respect to the collateral pledged by S&L under this note may at times be subordinate to S&L's obligations under, and the lender's rights with respect to, S&L's senior secured loan facility, including the lenders rights to the collateral pledge by S&L in connection with its senior secured loan facility. As a result, there can be no guarantee that S&L will pay us any portion of the principal due under this note or that upon any default by S&L we will have access to any of the collateral pledged by S&L under this note. Our collateral pledged by S&L under the A&R Note was not subordinated as of December 31, 2019.

Our investment in HC Realty may lose value.

In connection with using cash proceeds from the Asset Sale to acquire non-furniture related assets, we acquired an equity interest in HC Realty on March 19, 2019 by purchasing HC Common Stock and HC Series B Stock. As a result of these stock purchases, we currently own approximately 16.4% of the as-converted equity interest of HC Realty. On March 19, 2019, we also made a loan to HC Realty's operating partnership. There is no guarantee that HC Realty will be successful implementing its business strategy for the acquisition, management and disposition of GSA properties and as a result our HC Common Stock and HC Series B Stock may lose value and the repayment of our loan to HC Realty's operating partnership may be negatively impacted.

The value of our equity investment in HC Realty would be adversely affected if HC Realty failed to qualify as a REIT.

HC Realty has elected to be treated as a REIT for U.S. federal income tax purposes. Its continued qualification as a REIT depends on its satisfaction of certain asset, income, organizational, distribution and stockholder ownership requirements on a continuing basis. Its ability to satisfy some of the asset tests depends upon the fair market values of its assets, some of which are not able to be precisely determined and for which HC Realty has indicated it will not obtain independent appraisals. If HC Realty fails to qualify as a REIT in any taxable year, and certain statutory relief provisions are not available, HC Realty would be subject to U.S. federal income tax on its taxable income at regular corporate rates and distributions to stockholders would not be deductible by it in computing its taxable income. Any such corporate tax liability could be substantial and would reduce the amount of cash available for distribution. Unless entitled to relief under certain Internal Revenue Code provisions, HC Realty also would be disqualified from taxation as a REIT for the four taxable years following the year during which HC Realty ceased to qualify as a REIT. In addition, if HC Realty fails to qualify as a REIT, HC Realty will no longer be required to make distributions. As a result of all these factors, HC Realty's failure to qualify as a REIT could impair its ability to expand business and raise capital and could adversely affect the value of our HC Common Stock and HC Series B Stock.

An "ownership change" could limit the use of our net operating loss carryforwards and our potential to derive a benefit from our net operating loss carryforwards.

If an "ownership change" occurs pursuant to applicable statutory regulations, we are potentially subject to limitations on the use of our net operating loss carryforwards which in turn could adversely impact our potential to derive a benefit from our net operating loss carryforwards. While we have entered into a rights agreement designed to preserve and protect our net operating loss carryforwards, there is no guarantee that the rights agreement will prevent us from experiencing an ownership change and, therefore, having a limitation on our ability to use our net operating loss carryforwards. In general, an "ownership change" would occur if there is a cumulative change in the ownership of our common stock of more than 50% by one or more "5% shareholders" during a three-year test period.

We will continue to incur the expense of complying with public company reporting requirements following the closing of the Asset Sale.

Subsequent to the Asset Sale, we continue to be required to comply with the applicable reporting requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), even though compliance with such reporting requirements is economically burdensome.

Our common stock is listed on the OTCQB and there may be limited ability to trade our common stock.

Trading of our common stock is currently conducted in the over-the-counter market on the OTCQB, which is generally a less active, and therefore a less liquid, trading market than other types of markets such as a stock exchanges. As a result, an investor may find it more difficult to dispose of, or obtain accurate quotations for the price of, our common stock than if our stock was traded on other markets.

Failure to successfully identify, acquire and, to the extent applicable, operate non-furniture related assets could cause our stock price to decline.

Following the closing of the Asset Sale, we began evaluating alternatives for using cash proceeds from the Asset Sale to acquire non-furniture related assets. We have not acquired any assets other than the equity interest we acquired in HC Realty and we may not be able to identify other profitable assets. In addition, any assets that we do acquire, including our equity interest in HC Realty, may not be profitable. If we are not successful in identifying, acquiring and, to the extent applicable, operating non-furniture related assets, our stock price may decline.

We will likely have no operating history in the business of non- furniture related assets to be acquired, and therefore, with respect to certain assets, we will be subject to the risks inherent in establishing a new line of business.

Other than the equity interest we acquired in HC Realty, we have not identified additional assets to be acquired or the line or lines of business to which any such assets may relate and, therefore, cannot fully describe the specific risks presented by an acquisition of such assets. It is likely that we will have had no operating history in the line of business of any such assets to be acquired, and it is possible that any such assets that we may acquire will have a limited operating history in their business. Accordingly, to the extent we acquire any such assets, our future success may in part be subject to the risks, expenses, problems and delays inherent in establishing a new line of business and the ultimate success of such new business cannot be assured. In addition, prior to March 2019, our management did not have prior experience relating to the operations of a real estate investment trust such as HC Realty and the ultimate success of our investment in HC Realty cannot be assured.

Resources may be expended in researching potential acquisitions that might not be consummated.

The investigation of non-furniture company assets to acquire and the negotiation, drafting and execution of relevant agreements and other documents will require substantial management time and attention in addition to potentially incurring legal and other professional expenses. If a decision is made not to complete a specific acquisition, the costs incurred up to that point for the proposed transaction likely would not be recoverable. As of December 31, 2019, we had incurred \$10,000 of such related expenses. Furthermore, even if an agreement is reached relating to a specific acquisition, we may fail to consummate the acquisition for any number of reasons including those beyond our control.

Ownership may become diluted if we conduct a rights offering.

We have filed a registration statement with respect to a proposed rights offering of up to 19.5 million shares of our common stock (the "Rights Offering") to raise additional cash for acquisition purposes. If we conduct the Rights Offering and you do not participate, you will experience dilution in your ownership. The Rights Offering will be commenced only following the effectiveness of the registration statement relating to the Rights Offering and will be made only by means of a prospectus.

We may be required to register under the Investment Company Act of 1940.

Under Section 3(a)(1)(C) of the Investment Company Act of 1940 (the "1940 Act"), an issuer is deemed to be an investment company if it is engaged in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire "investment securities" having a value exceeding 40% of the value of the issuer's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis. The 1940 Act defines "investment securities" broadly to include virtually all securities except U.S. government securities and securities issued by majority-owned subsidiaries that are not themselves regulated or exempt investment companies. Consequently, the A&R Note and S&L Note may be considered investment securities and we may fall within the scope of Section 3(a)(1)(C) of the 1940 Act.

A company that falls within the scope of Section 3(a)(1)(C) of the 1940 Act can avoid being regulated as an investment company if it can rely on certain of the exclusions under the 1940 Act. One such exclusion is Rule 3a-2 under the 1940 Act, which allows a 3(a)(1)(C) investment company (as a "transient investment company") a grace period of one year from the date of classification (in our case, the date of the Asset Sale, which was March 2, 2018) to avoid registration under the 1940 Act, so long as it does not intend to engage primarily in the business of investing, reinvesting, owning, holding or trading in securities. While we did not acquire sufficient assets within one year from closing the Asset Sale as contemplated by Rule 3a-2, the Rule is a safe harbor and failure to comply with that Rule does not necessarily indicate a need to register under the 1940 Act.

We have actively pursued alternatives for using cash proceeds from the Asset Sale for the acquisition of non-furniture related assets and acquired an equity interest in HC Government Realty Trust, Inc. ("HC Realty") on March 19, 2019; however, we could become subject to the 1940 Act and be required to register under the 1940 Act. Registered investment companies are subject to extensive, restrictive and potentially adverse regulation relating to, among other things, operating methods, management, capital structure, dividends and transactions with affiliates.

If we are required to register under the 1940 Act, compliance with these additional regulatory burdens would increase our operating expenses.

Our common stock may be deemed a "penny stock."

Our common stock may be considered a "penny stock" as defined in the Exchange Act and the rules thereunder, unless the price of our shares of common stock is at least \$5.00. We expect that our share price will remain less than \$5.00. Unless our common stock is otherwise excluded from the definition of "penny stock", the penny stock rules apply. The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document that provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer also must provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker dealer and its sales person in the transaction, and monthly account statements showing the market value of each penny stock held in the customer's account. In addition, the penny stock rules require that the broker dealer, not otherwise exempt from such rules, must make a special written determination that the penny stock is suitable for the purchaser and receive the purchaser's written agreement to the transaction. These disclosure rules have the effect of reducing the level of trading activity in the secondary market for a stock that becomes subject to the penny stock rules. So long as our common stock is subject to the penny stock rules, the level of trading activity could be limited and it may be difficult for investors to sell our common stock.

Following the closing of the Asset Sale, we became a "shell company" under the federal securities laws.

As a result of the Asset Sale, we no longer had an operating business, and accordingly, after the closing of the Asset Sale, we became a shell company as defined by Rule 405 of the Securities Act and Exchange Act Rule 12b-2. As a result of our acquisition of an equity interest in HC Realty on March 19, 2019, we are no longer a shell company. However, applicable securities rules prohibit shell companies from using a Form S-8 registration statement to register securities pursuant to employee compensation plans and from utilizing Form S-3 for the registration of securities for 12 months after we cease to be a shell company.

To assist the Securities and Exchange Commission in the identification of shell companies, we were required to check a box on our quarterly reports on Form 10-Q and our annual reports on Form 10-K indicating that we were a shell company.

Under Rule 144 of the Securities Act, a holder of restricted securities of a company that was a "shell company" is not allowed to resell their securities in reliance upon Rule 144 for a period of 12 months after the company ceases to be a shell company and files required information with the Securities and Exchange Commission. The inability to utilize registration statements on Forms S-8 and S-3 would likely increase our costs to register securities in the future. Additionally, the loss of the use of Rule 144 and Form S-8 might make the offering and sale of our securities to employees, directors and others under compensatory arrangements more expensive and less attractive to recipients.

Our executive officers, directors and 10% stockholders have significant voting power and may vote their shares in a manner that is not in the best interest of other stockholders.

Our executive officers, directors and 10% stockholders control approximately 55% of the voting power represented by our outstanding common stock. If these stockholders act together, they may be able to exert significant control over our management and affairs requiring stockholder approval, such as the election of directors or the dissolution of the company. This concentration of ownership may have the effect of delaying or preventing a change in control and might adversely affect the market price of our common stock. This concentration of ownership may not be in the best interests of all our stockholders.

Our management, who will be employed on a part-time basis for the foreseeable future, currently has outside business interests that will require their time and attention and may interfere with their ability to devote all of their time to our business, which may adversely affect our business and operations.

Since our business will be limited until we find suitable non-furniture assets for acquisition, our only employees consist of our two executive officers, who will be employed for the foreseeable future on a part-time basis and who have outside business interests that could require substantial time and attention. Our executive officers are associated with Hale Partnership Capital Management LLC and devote significant time to its affairs. Our executive officers are also associated with HC Government Realty Trust, Inc.. On March 19, 2019, we acquired an equity interest in HC Realty and made a loan to HC Realty's operating partnership. We cannot accurately predict the amount of time and attention that will be required of our officers to perform their ongoing duties related to outside business interests. The inability of our officers to devote sufficient time to managing our business could have a material adverse effect on our business and operations.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our corporate headquarters is located in Charlotte, North Carolina where we lease approximately 1,200 square feet of office space.

Item 3. Legal Proceedings

Hollie Drive Litigation

In November 2019, we received notice that the Company and the Buyer were defendants in a pending case in the Circuit Court for Henry County, Virginia. The case, which had been instituted on September 18, 2019 by Hollie Drive Associates, LLC ("Hollie"), raises issues arising from the purported breach of a lease for warehouse space in Henry County, Virginia, which is owned by Hollie and was previously rented by the Company. The relevant lease was assigned to the Buyer in connection with the Asset Sale. The complaint asserts that the Buyer breached various provisions of the lease including failure to make certain rental payments and failure to pay for certain clean-up and reconstruction after the Buyer vacated the property. The complaint seeks damages in the amount of approximately \$555,000 and attorney's fees. Hollie named the Company as a party because the Company was the original tenant under the lease. Under the Asset Purchase Agreement, the Buyer agreed to assume and indemnify the Company against post-closing liabilities arising under the lease including those asserted in the complaint. The Buyer's filings in the case do not dispute the obligation to indemnify the Company for any damages awarded in the case. Based upon discussions with the Buyer and documents produced to date by Hollie, it appears Hollie has asserted damages greatly exceeding the likely recovery in the case. Given the relatively low damages amount and the Buyer's indemnity obligation, the Company believes it is unlikely the case will result in a material adverse effect on its consolidated financial statements.

Graham County Property Litigation

As previously disclosed, the Company received a letter from counsel for Graham County (the "County"), North Carolina asserting certain claims against the Company arising out of a conveyance to the County of approximately 36 acres (the "Property") in November 2014. The letter asserted that (i) the Company's failure to disclose the presence of environmental contamination on the Property constituted a breach of contract and (ii) the indemnity agreements entered into in connection with the conveyance were void. On November 26, 2019, the County filed a complaint against the Company and the Buyer in the Superior Court for Graham County, North Carolina seeking, among other things, (i) rescission of the conveyance of the Property to the County, (ii) reimbursement of expenses incurred by the County in connection with the Property, (iii) to invalidate the indemnity agreements entered into in connection with the conveyance, (iv) and other damages, or (iv), in the alternative to rescinding the conveyance, expenses necessary to make the Property suitable and useable for a public park and outdoor recreation area. Pursuant to the Asset Purchase Agreement, the Buyer agreed to assume and indemnify the Company against certain pre-closing liabilities including those relating to the conveyance of the Property. After the filing of the complaint, the Company entered into an agreement with the Buyer providing that, if the Company reaches a settlement with the County resulting in transfer of the Property back to the Company, then the Company can retain the Property notwithstanding provisions of the Asset Purchase Agreement and will waive any right to indemnification from the Buyer with respect to the claims by the County with respect to the Property. Based upon the discussions with the County related to the amount of expenses incurred by the County, the Company does not believe the claims asserted by the County will result in a material adverse effect on its consolidated financial statements.

Item 4. Mine Safety Disclosures

Not Applicable.

Information about our Executive Officers

Our executive officers who are elected annually and their ages as of January 1, 2020 are as follows:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Steven A. Hale II	36	Chairman, Chief Executive Officer and Director
Brad G. Garner	37	Principal Financial and Accounting Officer

Steven A. Hale II is the founder of Hale Partnership Capital Management, LLC, an asset management firm that serves as the investment manager to certain privately held investment partnerships. Mr. Hale has held his position since 2010. From 2007 to 2010, prior to founding Hale Partnership Capital Management, LLC, Mr. Hale was an associate director with Babson Capital Management, LLC, an asset management firm, where he had responsibility for coverage of distressed debt investments across a variety of industries. From 2005 to 2007, Mr. Hale was a leveraged finance analyst with Banc of America Securities. Mr. Hale has served as a director of the Company since February 2017 and as Chairman of the Company's Board of Directors since November 2017.

Brad G. Garner joined Hale Partnership Capital Management, LLC, an asset management firm that serves as the investment manager to certain privately held investment partnerships, in 2015 as Chief Financial Officer and Partner. Mr. Garner served as Chief Financial Officer of Best Bar Ever, Inc. while raising and structuring capital investments and successful exit to a strategic partner. Prior to taking on that role, he spent 10 years in public accounting at Dixon Hughes Goodman LLP.

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

Our common stock is traded in the over-the-counter market on the OTCQB under the symbol "STLY".

As of February 27, 2020, we had approximately 873 beneficial stockholders.

Issuer Purchases of Equity Securities

None.

Equity Compensation Plan Information

The following table summarizes our equity compensation plans as of December 31, 2019:

	Number of shares to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of shares remaining available for future issuance under equity compensation plans
Equity compensation plans approved by stockholders	42,283	\$6.20	1,186,429

Item 6. Selected Financial Data

Not required to be provided by a smaller reporting company.

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

Overview

On March 2, 2018, we sold substantially all of our assets to Churchill Downs LLC, pursuant to the terms of the Asset Purchase Agreement, dated as of November 20, 2017, as amended by the First Amendment thereto dated January 22, 2018. As consideration for the Asset Sale, Buyer paid a purchase price consisting of cash in the amount of approximately \$10.8 million (of which approximately \$1.3 million was used to pay the outstanding amount under our credit agreement), a subordinated promissory note in the principal amount of approximately \$7.4 million, and a 5% equity interest in Buyer's post-closing ultimate parent company, Churchill Downs Holdings Ltd., a British Virgin Islands business company. Buyer also assumed substantially all of our liabilities.

On September 6, 2018, the Buyer sold certain of its assets, including certain inventory and the Stone & Leigh tradename (the "S&L Asset Sale") to Stone & Leigh, LLC ("S&L"), which is owned by a group which included Matthew W. Smith, the Company's former interim Chief Executive Officer. As a part of the S&L Asset Sale, the Buyer assigned to S&L certain of its rights and obligations under the original \$7.4 million subordinated secured promissory note issued (the "Original Note") to the Company in March 2018 as partial consideration for the Asset Sale. In connection with the assignment, the Company entered into an Amended and Restated Subordinated Secured promissory note with the Buyer (the "A&R Note") with a principal amount as of the assignment date of \$3.3 million and a new Subordinated Secured Promissory Note with S&L (the "S&L Note") a principal amount of \$4.4 million as of the assignment date.

On February 7, 2019, the Company, Buyer and related parties entered into a Consent, Reaffirmation, and Joinder (the "Consent") in connection with a new senior credit facility that Buyer expected to enter into with Alterna Capital Solutions, LLC ("Alterna"). Pursuant to the Consent, Buyer paid \$180,000 of principal and accrued interest under the A&R Note as provided in the Consent and Buyer delivered a Seconded Amended and Restated Subordinated Secured Promissory Note (the "Second A&R Note") in favor of the Company. The Second A&R Note has a principal amount of \$3,201,536 and remains payable no later than March 2, 2023, at which time the total principal amount is due. Interest on the principal balance of the note continues to accrue daily at an annual fixed rate of 6%. The other terms of the Second A&R Note are substantially the same as those of the A&R Note. The Second A&R Note also remains guaranteed by Stanley Intermediate Holdings LLC, formerly Churchill Downs Intermediate Holdings LLC. Pursuant to the Consent, Buyer's British Virgin Island parent company has also guaranteed the Second A&R Note.

Pursuant to a stock purchase agreement dated February 7, 2019, Buyer's British Virgin Island parent company repurchased 2,500 shares of its stock held by the Company. The Company no longer maintains an equity interest in Buyer's British Virgin Island parent company. The Company recorded a gain on the sale of the stock of \$120,000 during the three months ended March 31, 2019.

The Company acquired an equity interest in HC Government Realty Trust, Inc., a Maryland corporation ("HC Realty"). HC Realty currently owns and operates a portfolio of 20 single-tenant properties leased entirely to the United States of America for occupancy by federal agencies including the Federal Bureau of Investigation, the Drug Enforcement Administration, the Social Security Administration and the Department of Transportation. On March 19, 2019, we purchased 300,000 shares of HC Realty's Common Stock (the "HC Common Stock") for an aggregate purchase price of \$3,000,000 and 200,000 shares of HC Realty's 10.00% Series B Cumulative Convertible Preferred Stock (the "HC Series B Stock") for an aggregate purchase price of \$2,000,000. As a result of these purchases, we currently own approximately 16.4% of the as-converted equity interest of HC Realty.

On March 19, 2019, we, together with certain other lenders, including certain entities affiliated with HPCM (collectively, the “Lenders”), entered into a loan agreement (the “Loan Agreement”) with HC Realty’s operating partnership, and HCM Agency, LLC, as collateral agent (the “Agent”), pursuant to which the Lenders provided HC Realty’s operating partnership with a \$10,500,000 senior secured term loan (the “Initial Term Loan”), of which \$2,000,000 was provided by us. The Agent is affiliated with HPCM.

On October 31, 2019, the Company entered into a Forbearance Agreement (the “Forbearance Agreement”) with the Buyer pursuant to which the Company has agreed to forbear from exercising its rights and remedies under Note until February 24, 2020 or earlier in the event of (i) a default or (ii) breach of the Forbearance Agreement by the Buyer. Under the Forbearance Agreement, the Buyer agreed to pay the Company \$220,000 on November 1, 2019 (the “Effective Date”), \$200,000 on or before the 30th day following the Effective Date, \$150,000 on or before the 60th day following the Effective Date, and \$130,000 on or before the 90th day following the Effective Date. As of December 31, 2019, the Buyer had made all scheduled payments under the Forbearance Agreement. The Company collected \$750,000 of principal repayments on the Second A&R Note during the twelve months ended December 31, 2019.

On February 24, 2020, the Company and the Loan Parties entered into a letter agreement (the “Forbearance Extension Letter Agreement”) extending the outside termination date for the forbearance period under the Forbearance Agreement from February 24, 2020 to February 26, 2020. The other terms and conditions of the Forbearance Agreement remain the same. The forbearance period terminated on February 26, 2020 under the terms of the Forbearance Extension Letter Agreement and Forbearance Agreement.

The Company received prepayments on February 28, 2020 and March 4, 2020 of \$200,000 and \$350,000, respectively, of the principal amount on the Second A&R Note from the Buyer.

On March 6, 2020, the Company and the Loan Parties entered into a letter agreement (the “Second Forbearance Extension Letter Agreement”) extending, subject to certain conditions, the outside termination date from February 26, 2020 to March 17, 2020. The extension of the outside termination and the effectiveness of the Second Forbearance Extension Letter Agreement is conditioned on Buyer making payments to be applied to the outstanding principal balance of the Second A&R Note of \$250,000 on or before March 12, 2020 and \$750,000 on or before March 13, 2020. The Second Forbearance Extension Letter Agreement also requires Buyer to make an additional \$391,970 payment on or before March 17, 2020 which will be applied to the outstanding principal balance of the Second A&R Note. The other terms and conditions of the Forbearance Agreement remain the same.

On March 12, 2020, the Company received payment from Buyer of \$250,000 pursuant to the Second Forbearance Extension Letter Agreement.

As a result of these actions taken on the subordinated secured promissory notes, the Company received approximately \$750,000 of principal repayments on the Second A&R Note and approximately \$1 million in principal repayments on the S&L Note during 2019.

The Company previously disclosed its board was considering a rights offering of the Company’s common stock to existing stockholders to raise additional cash for acquisitions. On December 16, 2019, the Company filed a registration statement with respect to the proposed Rights Offering. As set forth in the registration statement, which was amended on January 21, 2020 and February 14, 2020, the Company intends to use the proceeds of the rights offering to provide additional cash for acquisitions, including purchasing additional HC Series B Stock, HC Common Stock or debt of HC Realty. If the Rights Offering is fully subscribed, the Company anticipates using the proceeds of the Rights Offering to acquire a sufficient number of HC Series B Stock or HC Common Stock to control HC Realty as a result of the Company’s equity ownership of HC Realty. The Rights Offering will be commenced only following effectiveness of the registration statement relating to the Rights Offering and will be made only by means of a prospectus.

The Company continues to pursue acquisition opportunities which will allow us to potentially derive benefit from the Company’s net operating loss carryforwards and also create appropriate risk adjusted returns for shareholders.

Results of Operations

2019 Compared to 2018

On March 2, 2018, we sold substantially all of our assets (the “Asset Sale”) to Churchill Downs LLC (“Buyer”), pursuant to the terms of the Asset Purchase Agreement, dated as of November 20, 2017, as amended by the First Amendment thereto dated January 22, 2017 (the “Asset Purchase Agreement”). Operations of the furniture business from January 1, 2018 through March 2, 2018 are reflected as discontinued operation pursuant to the provisions of Accounting Standards Codification 2015-20, *Presentation of Financial Statements – Discontinued Operations* for all periods presented.

Loss from discontinued operations, net of taxes, comprised the following for the twelve months ended December 31, 2019 and 2018 (in thousands):

	Twelve Months Ended	
	Dec. 31, 2019	Dec. 31, 2018
Net sales	\$ -	\$ 6,787
Cost of sales	-	(6,485)
Selling, general and administrative expenses	-	(2,448)
Other income, net	-	-
Loss on sale of assets	-	(865)
Loss from discontinued operations before income taxes	-	(3,011)
Income tax benefit	-	-
Loss from discontinued operations, net of taxes	<u>\$ -</u>	<u>\$ (3,011)</u>

Included in selling, general and administrative expenses incurred for the twelve months ended December 31, 2018 were certain transaction costs including investment banking fees, legal fees, and other transaction costs directly attributable to the Asset Sale.

As of December 31, 2019, our sources of income include dividends on HC Common Stock and HC Series B Stock, interest earned on the loan we made to HC Realty's operating partnership, and interest paid on cash and subordinated secured promissory notes. The Company believes that the revenue generating from these sources in addition to the cash on hand is sufficient to fund operating expenses for at least 12 months from the date of these consolidated financial statements.

Results of Continuing Operations

Interest income for 2019 was \$1.0 million compared to \$0.9 million in 2018. Interest income for 2019 consisted of interest income of \$54,000 on our cash deposits, \$189,000 on the Second A&R Note from Buyer, \$356,000 on the S&L Note, \$223,000 on the Loan to Affiliate, and \$217,000 of accreted interest income on the fair value adjustment to the subordinated secured promissory notes. The Company's A&R Note from Buyer and S&L Note from S&L was paid cash interest current for the year ended December 31, 2019. Dividend income from HC Realty's Series B Stock was \$157,000 for the year ended December 31, 2019. During 2019, the Company received a distribution of its share of escrowed funds from Continued Dumping and Subsidy Offset Act ("CDSOA") of approximately \$1.2 million. The Company does not expect any future disbursements related to these escrow funds. The Company also sold its shares in Buyer's parent for a gain of \$120,000 during 2019.

General and administrative expenses for 2019 were \$1.1 million compared to \$1.0 million in 2018. General and administrative expenses for the year ended 2019 consisted \$217,000 of wages, \$519,000 of legal and professional fees, \$55,000 of fees and expenses primarily related to proxy, annual meeting voting, and other filing fees, \$69,000 of board compensation, \$98,000 of insurance expense, \$85,000 of stock-based compensation expense, and \$90,000 of other operating expenses.

Of the general and administrative expenses incurred in 2019, one-time legal, professional, and administrative fees were approximately \$50,000 related to the investments in HC Realty, \$10,000 related to a potential acquisition, \$71,000 related to the subordinated secured promissory notes, and \$122,000 were in connection with the registration statement for the Rights Offering filed on December 16, 2019.

During 2019, we recognized an impairment loss on the Second A&R Note from Buyer for \$0.9 million. The Company also recognized a Loss from Affiliate of \$0.4 million during 2019 related to the Company's investment in HC Realty's common stock that is accounted for under the equity method.

As a result of the above, our income from continuing operations before taxes was \$0.1 million in 2019, compared to \$0.4 million in 2018.

Excluding the disbursements of its share of CDSOA escrow funds, the Company did not receive any funds under the CDSOA in 2019. During the 2018 we received \$26,000.

During 2019, we recorded a non-cash income tax benefit of \$84,000 related to the increase in tax positions of prior years' in conjunction with our unrecognized tax benefits position under FIN 48. Our 2019 effective tax rate was (97.6)%, compared with 82.2% in 2018.

Financial Condition, Liquidity and Capital Resources

Sources of liquidity include cash on hand and cash interest earned on our cash on hand, [the Second A&R Note], and the S&L Note. We expect cash on hand to be adequate for ongoing operational expenditures for at least 12 months from the date of these financial statements. At December 31, 2019, we had \$2.6 million in cash and \$233,000 in restricted cash. A portion of our unrestricted and restricted cash is currently held in savings accounts earning approximately 1.4%. We are being paid current interest on the Second A&R Note, the S&L Note with Stone & Leigh, LLC, and under the Loan Agreement with HC Realty. We also received quarterly dividends on our HC Realty common and Series B Stock at annual rates of 5.5% and 10% annual rates, respectively.

Cash provided by continuing operations was \$1.4 million in 2019 as compared to cash used of \$900,000 in 2018. Cash provided by continuing operations for 2019 consisted of \$840,000 of cash interest income received, \$1.2 million of CDSOA escrow distributions, and \$107,000 of dividends on our HC Realty Series B Stock offset by \$781,000 of payments to employees and suppliers. The payments to employees and suppliers primarily consisted of \$218,000 of wages to current management, \$69,000 of directors' fees, \$404,000 of legal and professional fees, and \$24,000 of insurance premiums.

Cash used by investing activities included the Company's investment in HC Realty's common stock and Series B Stock of \$3 million and \$2 million, respectively. The Company also provided HC Realty's operating partnership \$2 million under the Loan Agreement. The Company received \$120,000 of proceeds from the sale of our shares in Buyer's parent company and received cash principal payments on the subordinated secured promissory notes of approximately \$1.8 million.

Continued Dumping and Subsidy Offset Act ("CDSOA")

The CDSOA provides for distribution of monies collected by U.S. Customs and Border Protection ("Customs") for imports covered by antidumping duty orders entering the United States through September 30, 2007 to eligible domestic producers that supported a successful antidumping petition ("Supporting Producers") for wooden bedroom furniture imported from China. Antidumping duties for merchandise entering the U.S. after September 30, 2007 have remained with the U.S. Treasury.

In November 2018, Customs distributed \$66,000 in collected duties that were available for distribution in 2018. Our portion of these distributions was \$26,000, representing 39.9% of the balance available for distribution in 2018. As a result of revisions to our percentage allocation, the Company does not expect any material future distributions for collected duties. There were no distributions of collected duties to the Company in 2019.

As the CDSOA distributed monies collected by Customs to eligible domestic producers that supported a successful antidumping petition ("Supporting Producers"), a portion of the proceeds were retained and held in an escrow account in order to fund future expenses (such as professional fees) related to the petition. During the first quarter of 2019, the Supporting Producers group decided, based on the current facts and circumstances of the petition, to disburse the portion of those funds related to the 2013, 2014, and first half of 2015 distributions. The Company's share of the escrow release was approximately \$1.2 million, which we received on March 15, 2019. The group of Supporting Producers expect that any remaining funds held in escrow will be used for future expenses related to the petition. The Company does not expect any future disbursements related to these escrow funds.

New Accounting Pronouncements

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* ("ASU 2016-13"). The amendments in ASU 2016-13 require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendment is effective for public entities for annual reporting periods beginning after December 15, 2019, however early application is permitted for reporting periods beginning after December 15, 2018. The Company does not anticipate the adoption of ASU 2016-13 to have a material impact to the consolidated financial statements.

In February 2016, the FASB issued its final lease accounting standard, FASB Accounting Standard Codification ("ASC"), *Leases (Topic 842)* ("ASU 2016-02"), which requires lessees to recognize a right-of-use asset and a lease liability for virtually all of their leases (other than leases that meet the definition of a short-term lease). The lease liability will be equal to the present value of lease payments and the right-of-use asset will be based on the lease liability, subject to adjustment such as for initial direct costs. For income statement purposes, the new standard retains a dual model similar to ASC 840, requiring leases to be classified as either operating or finance. For lessees, operating leases will result in straight-line expense (similar to current accounting by lessees for operating leases under ASC 840) while finance leases will result in a front-loaded expense pattern (similar to current accounting by lessees for capital leases under ASC 840). The Company adopted the standard effective January 1, 2019. As of December 31, 2019, we do not have any long-term leases. We will evaluate the effect that ASU 2016-02 will have on our consolidated financial statements and related disclosures at such time a long-term lease is executed. Our only lease as of December 31, 2019 relates to a real estate lease for the corporate office space. The adoption did not have material impact to the consolidated financial statements.

Critical Accounting Policies

We have chosen accounting policies that are necessary to accurately and fairly report our operational and financial position. Below are the critical accounting policies that involve the most significant judgments and estimates used in the preparation of our consolidated financial statements.

Equity Method Investments - Long-term investments consist of investments in equity securities where our ownership is less than 50% and the Company has the ability to exercise influence, but not control, over the investee. These investments are classified in "Investment in affiliate" on the consolidated balance sheets. The Company records the investment at costs and subsequently increases or decreases the investment by its proportionate share of the net income or loss and other comprehensive income or loss of the investee. If the Company believes a decline in market value below cost is other than temporary, a loss is charged to earnings, which establishes a new cost basis for the security. The Company determination of whether an equity method investment is other than temporarily impaired incorporates both quantitative and qualitative information. The Company considers a number of factors including, but not limited to, the length of time and the extent to which the fair value has been less than cost, the length of time expected for recovery, the financial condition of the investee, the reason for decline in fair value, the ability and intent to hold the investment to maturity, and other factors specific to the individual investment.

Cost Method Investments - Long-term investments consist of investments in equity securities of nonpublic entities without readily determinable fair values. These investments are classified in "Investment in closely held company" on the consolidated balance sheets. The company determines the appropriate classifications of its investment(s) at the acquisition date. Upon adoption of ASU 2016-01, the Company carries its long-term investment at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transaction for the identical or a similar investment of the same issuer.

Note Receivable - In accordance with ASC 810-40-5, upon the sale of substantially all of the assets the Company recorded a gain on the deconsolidation of a group of assets based on the difference between the fair value of the consideration received and the carrying amount of the group of assets. As the Original Note was part of the consideration received, the Company recorded the Original Note at its fair value on March 2, 2018. The fair value of the Original Note was estimated using discounted cash flow analyses, using market rates at the acquisition date that reflect the credit and inherent rate-risk inherent in the Original Note. The discount resulting from the fair value adjustment was recorded as a direct reduction to the original principal balance and amortized to interest income using the effective interest method. As of the date of the assignment and transfer from the Buyer to S&L, it was determined that the Original Note was extinguished and therefore both the A&R Note and the S&L Note were measured based on their fair value in accordance with Emerging Issues Task Force (EITF) – *Creditors Accounting for Modification or Exchange of Debt Instruments*. The discounts resulting from the fair value adjustments for the A&R Note and the S&L Note were recorded as a direct reduction to the original principal balance and amortized to interest income using the effective interest method. When impairment is determined to be probable, the measurement will be based on the fair value of the collateral securing the notes. The determination of impairment involves management's judgment and the use of market and third-party estimates regarding collateral values.

Variable Interest Entities ("VIE") - As a result of both the Asset Sale and the S&L Asset Sale, we have a variable interest in two entities that have been determined to be variable interest entities ("VIE"). If we conclude that we are the primary beneficiary of a VIE, we are required to consolidate it. To determine if we are the primary beneficiary, we evaluate whether we have the power to direct the activities that most significantly impact the VIE's economic performance and the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. Our evaluation includes identification of significant activities and an assessment of our ability to direct those activities based on governance provisions and arrangements to provide or receive product and process technology, product supply, operations services, equity funding, financing, and other applicable agreements and circumstances. Our assessments of whether we are the primary beneficiary of our VIE requires significant assumptions and judgments. We have concluded that we are not the primary beneficiary of the two VIEs as we do not have the power to direct the activities that most significantly impact the VIEs' economic performance and therefore are not required to consolidate these entities.

Revenue Recognition – Revenue, prior to the Asset Sale, was recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. To achieve this principle, the Company performed the following five steps: (i) identification of a contract with a customer; (ii) identification of any separate performance obligation; (iii) determination of the transaction price; (iv) allocation of the transaction price to the performance obligation in the contract, if any; and (v) recognition of revenue when the Company had satisfied the underlying performance obligation if any. The Company recognized substantially all of its revenue at a point in time when control of the Company’s goods was passed to the customer, which typically occurs upon shipment, with the exception of consigned goods. The Company considered its performance obligation satisfied at the time this control was transferred. Customer payment terms for these shipments typically ranged between 30- and 90-days. The Company elected to treat shipping and handling performed after control has transferred to customers as a fulfillment activity, and additionally, elected the practical expedient to report sales taxes on a net basis. The Company recorded shipping and handling expense related to product sales as cost of sales.

Interest Income – Interest income is recorded on an accrual basis based on the effective interest rate method to the extent that we expect to collect such amounts.

Deferred taxes - On December 22, 2017, the Tax Cuts and Jobs Act (the “Act”) was enacted into law. The income tax effects of changes in tax laws are recognized in the period when enacted. Among its numerous changes to the Internal Revenue Code, the Act reduces U.S. corporate rates from 35% to 21% for periods beginning on or after January 1, 2018. Our deferred tax assets were remeasured in 2017 at the lower corporate tax rate, however, this was offset by a corresponding adjustment to the Company’s full valuation allowance. During 2018, the Company finalized its analysis of the impact of the Act including determining the appropriate amount of AMT credits to be refunded in future periods. This resulted in an income tax benefit of \$988,000 in 2018 for the amount of supportable credits on the Company’s prior period tax returns.

We recognize deferred tax assets and liabilities based on the estimated future tax effects of differences between the financial statements and the tax basis of assets and liabilities given the enacted tax laws. We evaluate the need for a deferred tax asset valuation allowance by assessing whether it is more likely than not that the company will realize its deferred tax assets in the future. The assessment of whether or not a valuation allowance is required often requires significant judgment, including the forecast of future taxable income. Adjustments to the deferred tax valuation allowance are made to earnings in the period when such assessment is made.

In preparation of our consolidated financial statements, we exercise judgment in estimating the potential exposure to unresolved tax matters and apply a more likely than not criteria approach for recording tax benefits related to uncertain tax positions. While actual results could vary, we believe we have adequate tax accruals with respect to the ultimate outcome of such unresolved tax matters.

Long-lived assets - Property, plant and equipment is reviewed for possible impairment when events indicate that the carrying amount of an asset may not be recoverable. Assumptions and estimates used in the evaluation of impairment may affect the carrying value of long-lived assets, which could result in impairment charges in future periods that would lower our earnings. Our depreciation policy reflects judgments on the estimated remaining useful lives of assets.

Accruals for self-insurance reserves - Accruals for self-insurance reserves (including workers’ compensation and employee medical) are determined based on a number of assumptions and factors, including historical payment trends and claims history, actuarial assumptions and current and estimated future economic conditions. These estimated liabilities are not discounted. If actual trends differ from these estimates, the financial results could be impacted. Historical trends have not differed materially from these estimates.

Stock-Based Compensation - We record share-based payment awards at fair value on the grant date of the awards, based on the estimated number of awards that are expected to vest, over the vesting period. The fair value of stock options was determined using the Black-Scholes option-pricing model. The fair value of the restricted stock awards was based on the closing price of the Company’s common stock on the date of the grant. For awards with performance conditions, we recognize compensation cost over the expected period to achieve the performance conditions, provided achievement of the performance conditions are deemed probable.

Off-Balance Sheet Arrangements

We do not have transactions or relationships with “special purpose” entities, and we do not have any off-balance sheet financing other than normal operating leases for office space.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Not required to be provided by a smaller reporting company.

Item 8. Financial Statements and Supplementary Data

The consolidated financial statements and schedule listed in items 15(a) (1) and (a) (2) hereof are incorporated herein by reference and are filed as part of this report.

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

None.

Item 9A. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based on this evaluation, our principal executive officer and our principal financial officer concluded our disclosure controls and procedures were effective as of December 31, 2019, the end of the period covered by this Annual Report.

Management’s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control-Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2019.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the fourth quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information related to our directors is set forth under the caption “Election of Directors” of our proxy statement (the “2020 Proxy Statement”) for our 2020 annual meeting of shareholders. Such information is incorporated herein by reference.

Information relating to compliance with section 16(a) of the Exchange Act is set forth under the caption “Delinquent Section 16(a) Reports” of our 2020 Proxy Statement and is incorporated herein by reference.

Information relating to the Audit Committee and Board of Directors’ determinations concerning whether a member of the Audit Committee of the Board is a “financial expert” as that term is defined under Item 407(d) (5) of Regulation S-K is set forth under the caption “Board and Board Committee Information” of our 2020 Proxy Statement and is incorporated herein by reference.

Information concerning our executive officers is included in Part I of this report under the caption “Information about our Executive Officers.”

We have adopted a code of ethics that applies to our associates, including the principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. Our code of ethics is posted on our website at www.hgholdingsinc.net. Amendments to and waivers from our code of ethics will be posted to our website when permitted by applicable SEC rules and regulations.

Item 11. Executive Compensation

Information relating to our executive compensation is set forth under the caption “Executive Compensation” of our 2020 Proxy Statement. Such information is incorporated herein by reference.

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

Our information relating to this item is set forth under the caption “Security Ownership of Certain Beneficial Owners and Management” of our 2020 Proxy Statement. Such information is incorporated herein by reference.

Information concerning our equity compensation plan is included in Part II of this report under the caption “Equity Compensation Plan Information.”

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

Our information relating to this item is set forth under the captions “Corporate Governance – Review of Transactions with Related Persons” and “Corporate Governance - Board and Board Committee Information” of our 2020 Proxy Statement. Such information is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

Our information relating to this item is set forth under the caption “Independent Public Auditors” of our 2020 Proxy Statement. Such information is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Documents filed as a part of this Report:

(1) The following consolidated financial statements are included in this report on Form 10-K:

Report of Independent Registered Public Accounting Firm
Consolidated Balance Sheets as of December 31, 2019 and 2018
Consolidated Statements of Operations for each of the two years in the period ended December 31, 2019
Consolidated Statements of Comprehensive Income for each of the two years ended in the period ended December 31, 2019
Consolidated Statements of Changes in Stockholders' Equity for each of the two years in the period ended December 31, 2019
Consolidated Statements of Cash Flows for each of the two years in the period ended December 31, 2019
Notes to Consolidated Financial Statements

(2) Financial Statement Schedule:

Schedule II – Valuation and Qualifying Accounts for each of the two years in the period ended December 31, 2019

(b) Exhibits:

- 2.1 [Asset Purchase Agreement, dated as of November 20, 2017, by and between Churchill Downs, LLC and Stanley Furniture Company, Inc. \(incorporated by reference to Exhibit 2.1 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed on November 20, 2017\). \(1\)](#)
- 2.2 [First Amendment to Asset Purchase Agreement, dated as of January 22, 2018, by and between Churchill Downs, LLC and Stanley Furniture Company, Inc. \(incorporated by reference to Exhibit 2.1 to the Registrant's Form 8-K \(Commission File No. 0-14938\) filed on January 23, 2018\). \(1\)](#)
- 3.1 [Restated Certificate of Incorporation of the Registrant \(incorporated by reference to Exhibit 3.1 to the Registrant's Form 10-K \(Commission File No. 0-14938\) for the year ended December 31, 2017\).](#)
- 3.2 [By-laws of the Registrant as amended \(incorporated by reference to Exhibit 3.1 to the Registrant's Form 8-K \(Commission File No. 0-14938\) filed November 20, 2017\).](#)
- 3.3 [Certificate of Designation of Series A Participating Preferred Stock of Stanley Furniture Company, Inc. \(incorporated by reference to Exhibit 3.1 to the Registrant's Form 8-K \(Commission File No. 0-14938\) filed December 6, 2016\).](#)
- 4.1 [The Certificate of Incorporation, By-laws and Certificate of Designation of Series A Participating Preferred Stock of the Registrant as currently in effect \(incorporated by reference to Exhibit 3.1, Exhibit 3.2 and Exhibit 3.3 hereto\).](#)
- 4.2 [Rights Agreement, dated as of December 5, 2016, between Stanley Furniture Company, Inc. and Continental Stock Transfer & Trust Company, as Rights Agent \(incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K \(Commission File No. 0-14938\) filed December 6, 2016\).](#)
- 4.3 [Amendment No. 1, dated as of January 30, 2017, to the Rights Agreement, dated as of December 5, 2016, between Stanley Furniture Company, Inc. and Continental Stock Transfer & Trust Company, as Rights Agent \(incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K \(Commission Rule No. 0-14938\) filed January 30, 2017\).](#)
- 4.4 [Amendment No. 2, dated as of December 5, 2019, to the Rights Agreement, dated as of December 5, 2016, between HG Holdings, Inc. and Continental Stock Transfer & Trust Company, as Rights Agent \(incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K \(Commission Rule No. 0-14938\) filed December 5, 2019\).](#)
- 4.5 [Description of the Company's Securities Registered Pursuant to Section 12 of the Securities Exchange Act of 1934. \(3\)](#)
- 10.1 [Form of Indemnification Agreement between the Registrant and each of its Directors \(incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K \(Commission File No. 0-14938\) filed on September 25, 2008\).](#)
- 10.2 [2008 Incentive Compensation Plan \(incorporated by reference to Exhibit A to the Registrant's Proxy Statement \(Commission File No. 0-14938\) for the annual meeting of stockholders held on April 15, 2008\). \(2\)](#)

- 10.3 [Form of Stock Option Award under 2008 Incentive Plan \(Directors\) \(incorporated by reference to Exhibit 10.22 to the Registrant's Form 10-K \(Commission File No. 0-14938\) for the year ended December 31, 2008\). \(2\)](#)
- 10.4 [2012 Incentive Compensation Plan \(incorporated by reference to Exhibit A to the Registrant's Proxy Statement \(Commission File No. 0-14938\) for the annual meeting of stockholders held on April 18, 2012\). \(2\)](#)
- 10.5 [Form of Stock Option Award under 2012 Incentive Plan \(Officers\) \(incorporated by reference to Exhibit 10.19 to the Registrant's Form 10-K \(Commission File No. 0-14938\) for the year ended December 31, 2012\). \(1\)](#)
- 10.6 [Form of Restricted Stock Award under 2012 Incentive Plan \(Officers\) \(time vesting\) \(incorporated by reference to Exhibit 10.20 to the Registrant's Form 10-K \(Commission File No. 0-14938\) for the year ended December 31, 2012\). \(2\)](#)
- 10.7 [Form of Restricted Stock Award under 2012 Incentive Plan \(Directors\) \(incorporated by reference to Exhibit 10.21 to the Registrant's Form 10-K \(Commission File No. 0-14938\) for year ended December 31, 2014\). \(2\)](#)
- 10.8 [Form of Restricted Stock Award under 2012 Incentive Plan \(Officers\) \(time and performance vesting\) \(incorporated by reference to Exhibit 10.22 to the Registrant's Form 10-K \(Commission File No. 0-14938\) for year ended December 31, 2014\). \(2\)](#)
- 10.9 [Form of Restricted Stock Award under 2012 Incentive Plan \(Officers\) \(performance vesting\) \(incorporated by reference to Exhibit 10.23 to the Registrant's Form 10-K \(Commission File No. 0-14938\) for year ended December 31, 2014\). \(2\)](#)
- 10.10 [Agreement, dated as of January 30, 2017, by and among Stanley Furniture Company, Inc. and the entities and natural persons listed on Exhibit A thereto \(incorporated by reference to Exhibit 10.1 to Registrant's Form 8-K \(Commission File No. 0-14938\) filed January 30, 2017\).](#)
- 10.11 [Subordinated Promissory Note, dated March 2, 2018, of Churchill Downs LLC in favor of Stanley Furniture Company, Inc. \(incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on March 8, 2018\).](#)
- 10.12 [Amended and Restated Subordinated Secured Promissory Note, dated September 6, 2018, issued by Stanley Furniture Company LLC in favor of HG Holdings, Inc. \(incorporated by reference to Exhibit 10.1 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed September 12, 2018\).](#)
- 10.13 [Subordinated Secured Promissory Note, dated September 6, 2018, issued by Stone & Leigh, LLC in favor of HG Holdings, Inc. \(incorporated by reference to Exhibit 10.2 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed September 12, 2018\).](#)
- 10.14 [Intercreditor and Debt Subordination Agreement, dated September 6, 2018, between HG Holdings, Inc. and Hale Partnership Fund, L.P., as agent \(incorporated by reference to Exhibit 10.3 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed September 12, 2018\).](#)
- 10.15 [Second Amended and Restated Subordinated Secured Promissory Note, dated February 7, 2019, issued by Stanley Furniture Company LLC in favor of HG Holdings, Inc. \(incorporated by reference to Exhibit 10.1 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed February 13, 2019\).](#)
- 10.16 [Consent, Reaffirmation and Joinder, dated February 7, 2019, among Stanley Furniture Company LLC, Stanley Intermediate Holdings LLC, Churchill Downs Holdings Ltd., Stanley Furniture Company 2.0, LLC and HG Holdings, Inc. \(incorporated by reference to Exhibit 10.2 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed February 13, 2019\).](#)

- 10.17 [Agreement, dated February 7, 2019, between HG Holdings, Inc. and Churchill Downs Holdings Ltd. \(incorporated by reference to Exhibit 10.3 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed February 13, 2019\).](#)
- 10.18 [Intercreditor and Subordination Agreement, dated February 25, 2019, among HG Holdings, Inc. and Alterna Capital Solutions, LLC \(incorporated by reference to Exhibit 10.1 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed March 1, 2019\).](#)
- 10.19 [Subscription Agreement, dated as of March 19, 2019, by and between HC Government Realty Trust, Inc. and HG Holdings, Inc., with respect to the purchase of shares of Common Stock \(incorporated by reference to Exhibit 10.1 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed March 25, 2019\).](#)
- 10.20 [Subscription Agreement, dated as of March 19, 2019, by and between HC Government Realty Trust, Inc., and HG Holdings, Inc., with respect to the purchase of shares of Series B Stock \(incorporated by reference to Exhibit 10.2 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed March 25, 2019\).](#)
- 10.21 [Loan Agreement, dated as of March 19, 2019, by and between HC Government Realty Holdings, L.P., as borrower, the Lenders party thereto and HCM Agency, LLC, as collateral agent \(incorporated by reference to Exhibit 10.3 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed March 25, 2019\).](#)
- 10.22 [Forbearance Agreement, dated as of October 31, 2019, by and among Stanley Furniture Company LLC, Stanley Intermediate Holdings LLC, Stanley Furniture Company 2.0, LLC and Churchill Downs Holdings Ltd., and HG Holdings, Inc. \(incorporated by reference to Exhibit 10.1 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed November 1, 2019\).](#)
- 10.23 [Forbearance Extension Letter Agreement, dated as of February 24, 2020, by and among Stanley Furniture Company LLC, Stanley Intermediate Holdings LLC, Stanley Furniture Company 2.0, LLC and Churchill Downs Holdings Ltd., and HG Holdings, Inc. \(incorporated by reference to Exhibit 10.1 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed February 25, 2020\).](#)
- 10.24 [Second Forbearance Extension Letter Agreement, dated as of March 6, 2020, by and among Stanley Furniture Company LLC, Stanley Intermediate Holdings LLC, Stanley Furniture Company 2.0, LLC and Churchill Downs Holdings Ltd., and HG Holdings Inc. \(incorporated by reference to Exhibit 10.1 of the Registrant's Form 8-K \(Commission File No. 0-14938\) filed March 12, 2020\).](#)
- 21 [List of Subsidiaries. \(3\)](#)
- 23.1 [Consent of Cherry Bekaert LLP. \(3\)](#)
- 23.2 [Consent of BDO USA, LLP. \(3\)](#)
- 31.1 [Certification by Steven A. Hale II, our Chairman and Chief Executive Officer, pursuant to Rule 13a-14\(a\)/15d-14\(a\) of the Securities Exchange Act of 1934, as amended. \(3\)](#)
- 31.2 [Certification by Brad G. Garner, our Principal Financial and Accounting Officer, pursuant to Rule 13a-14\(a\)/15d-14\(a\) of the Securities Exchange Act of 1934, as amended. \(3\)](#)
- 32.1 [Certification by Steven A. Hale II, our Chairman and Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. \(4\)](#)
- 32.2 [Certification by Brad G. Garner, our Principal Financial and Accounting Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. \(4\)](#)
- 99.1 [Annex D excerpted and incorporated by reference from the Registrant's Form S-1/A Registration Statement \(Registration No. 333-235539\) filed on February 14, 2020. \(3\)](#)
- 101 The following financial statements from the Company's Annual Report on Form 10-K for the year ended December 31, 2019, formatted in Extensible Business Reporting Language ("XBRL"): (i) consolidated balance sheets, (ii) consolidated statements of operations, (iii) condensed consolidated statements of comprehensive (loss) income, (iv) condensed consolidated statements of cash flows, (v) the notes to the consolidated financial statements, and (vi) document and entity information. (3)

-
- (1) Certain schedules to these agreements have been omitted in accordance with Item 601(b)(2) of Regulation S-K. A copy of any omitted schedules and/or exhibits will be furnished to the SEC upon request.
- (2) Management contract or compensatory plan
- (3) Filed Herewith
- (4) Furnished Herewith

Item 16. 10-K Summary

None.

SIGNATURES

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

HG HOLDINGS, INC.

March 13, 2020

By: /s/Steven A. Hale II
Steven A. Hale II
Chairman, Chief Executive Officer and Director

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

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/Steven A. Hale II</u> (Steven A. Hale II)	Chairman, Chief Executive Officer and Director	March 13, 2020
<u>/s/Brad G. Garner</u> (Brad G. Garner)	Principal Financial and Accounting Officer	March 13, 2020
<u>/s/Matthew A. Hultquist</u> (Matthew A. Hultquist)	Director	March 13, 2020
<u>/s/Jeffrey S. Gilliam</u> (Jeffrey S. Gilliam)	Director	March 13, 2020

HG HOLDINGS, INC.
ANNUAL REPORT ON FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2019
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders
HG Holdings, Inc.
Charlotte, North Carolina

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheet of HG Holdings, Inc. (the “Company”) and subsidiaries as of December 31, 2019, the related consolidated statements of operations and comprehensive income, changes in stockholders’ equity, and cash flows for the year ended December 31, 2019, and the related notes and financial statement schedule listed in the accompanying index (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2019, and the results of its operations and its cash flows for year ended December 31, 2019, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

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

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

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

We have served as the Company’s auditor since 2019.

/s/ Cherry Bekaert, LLP
Richmond, Virginia

March 13, 2020

Report of Independent Registered Public Accounting Firm

Stockholders and Board of Directors
HG Holdings, Inc.
Charlotte, North Carolina

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheet of HG Holdings, Inc. (the "Company") as of December 31, 2018, the related consolidated statements of operations and comprehensive loss, stockholders' equity, and cash flows for the year ended December 31, 2018, and the related notes and financial statement schedule listed in the accompanying index (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2018, and the results of its operations and its cash flows for the year ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

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

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

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

/s/ BDO USA, LLP

We have served as the Company's auditor from 2014 to 2018.

Raleigh, North Carolina
March 29, 2019

HG HOLDINGS, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	2019	2018
ASSETS		
Current assets:		
Cash	\$ 2,567	\$ 6,057
Restricted cash	233	404
Interest and dividend receivables	91	-
Prepaid expenses and other current assets	176	273
Income tax receivable	735	488
Total current assets	3,802	7,222
Property, plant and equipment, net	7	9
Investment in affiliate	4,405	-
Subordinated notes receivable	3,379	5,882
Loan to affiliate	2,000	-
Other assets	494	480
Deferred tax assets	247	494
Total assets	\$ 14,334	\$ 14,087
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 7	\$ 29
Accrued salaries, wages and benefits	5	17
Other accrued expenses	168	110
Total current liabilities	180	156
Other long-term liabilities	255	287
Total liabilities	435	443
STOCKHOLDERS' EQUITY		
Common stock, \$0.02 par value, 35,000,000 and 25,000,000 shares authorized, 14,946,839 and 14,712,377 shares issued and outstanding on each respective date	294	294
Capital in excess of par value	17,370	17,285
Retained deficit	(3,765)	(3,935)
Accumulated other comprehensive loss	-	-
Total stockholders' equity	13,899	13,644
Total liabilities and stockholders' equity	\$ 14,334	\$ 14,087

The accompanying notes are an integral part
of the consolidated financial statements.

HG HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	For the Years Ended	
	December 31,	
	<u>2019</u>	<u>2018</u>
Operating Expenses		
General and administrative expenses	\$ (1,133)	\$ (1,005)
Total operating expenses	(1,133)	(1,005)
Interest income	1,039	943
Dividend income	157	-
Product financing interest income	-	125
Gain on sale of closely held stock	120	-
Gain on extinguishment of subordinated note receivable	-	448
Loss from affiliate	(430)	-
Income from Continued Dumping and Subsidy Offset Act, net	1,230	26
Impairment loss	(897)	(168)
Income from continuing operations before income taxes	86	369
Income tax benefit	84	1,202
Income from continuing operations	170	1,571
Discontinued operations		
Loss from discontinued operations (including loss on sale of assets of \$865)	\$ -	\$ (3,011)
Net income (loss)	<u>\$ 170</u>	<u>\$ (1,440)</u>
Basic and diluted income (loss) per share:		
Income (loss) from continuing operations	\$.01	\$.11
Loss from discontinued operations	-	(.21)
Net income (loss)	<u>\$.01</u>	<u>\$ (.10)</u>
Weighted average shares outstanding:		
Basic	<u>14,507</u>	14,531
Diluted	<u>14,937</u>	<u>14,574</u>

The accompanying notes are an integral part
of the consolidated financial statements.

HG HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	For the Years Ended	
	December 31,	
	2019	2018
Net income (loss)	\$ 170	\$ (1,440)
Settlement of employee benefit obligations directly related to the disposal transaction	-	2,422
Comprehensive income	<u>\$ 170</u>	<u>\$ 982</u>

The accompanying notes are an integral part
of the consolidated financial statements.

HG HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For each of the two years in the period ended December 31, 2019
(in thousands)

	Common Stock		Capital Excess of Par Value	Retained Earnings (Deficit)	Accumulated Other Comprehensive (Loss) Income	Total
	Shares	Amount				
Balance at December 31, 2017	14,920	\$ 298	\$ 17,104	\$ (2,495)	\$ (2,422)	\$ 12,485
Net loss	-	-	-	(1,440)	-	(1,440)
Other comprehensive loss	-	-	-	-	2,422	2,422
Dividends	-	-	(139)	-	-	(139)
Restricted stock forfeited or expired	(101)	-	-	-	-	-
Stock purchase and retirement for tax withholdings on vesting of restricted awards	(268)	(4)	(129)	-	-	(133)
Stock-based compensation	161	-	449	-	-	449
Balance at December 31, 2018	14,712	\$ 294	\$ 17,285	\$ (3,935)	\$ -	\$ 13,644
Net income	-	-	-	170	-	170
Restricted stock forfeited or expired	(182)	-	-	-	-	-
Stock-based compensation	417	-	85	-	-	85
Balance at December 31, 2019	<u>14,947</u>	<u>\$ 294</u>	<u>\$ 17,370</u>	<u>\$ (3,765)</u>	<u>\$ -</u>	<u>\$ 13,899</u>

The accompanying notes are an integral part
of the consolidated financial statements.

HG HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Years Ended December 31,	
	2019	2018
Income from continuing operations	\$ 170	\$ 1,571
Adjustments to reconcile net income from operations to net cash flows from operating activities:		
Depreciation expense	2	1
Accretion income on notes receivable	(217)	(327)
Stock compensation expense	85	58
Paid in kind interest on subordinated note receivable	-	(337)
Gain on extinguishment of subordinated note receivable	-	(448)
Gain on sale of closely held stock	(120)	-
Impairment loss on subordinated note receivable	897	-
Dividends on HC Realty common stock	124	-
Loss from affiliate	430	-
Changes in assets and liabilities:		
Prepaid expenses and other current assets	47	(208)
Income tax receivables	(247)	(488)
Deferred tax assets and other assets	232	(509)
Accounts payable	(22)	29
Accrued salaries and other accrued expenses	46	34
Other long-term liabilities	(32)	(280)
Net cash provided (used) by continuing operations	1,395	(904)
Cash flows from investing activities:		
Purchase of property, plant and equipment	-	(10)
Investment in affiliate	(5,000)	-
New advances on loan receivable from affiliate	(2,000)	-
Principal payments received on subordinated secured notes Receivable	1,824	-
New borrowings on subordinated secured notes receivable	-	(29)
Proceeds from sale of closely held stock	120	-
Net cash used by investing activities	(5,056)	(39)
Cash flows from financing activities:		
Repurchase and retirement of common stock	-	(133)
Stock purchase and retirement for tax withholdings on vesting of restricted award	-	(30)
Net cash used by financing activities	-	(163)
Cash flows from discontinued operations:		
Cash used by discontinued operation	-	(3,501)
Cash provided by investing activities	-	9,228
Cash provided by financing activities	-	1,209
Net cash provided by discontinued operations	-	6,936
Net increase (decrease) in cash and restricted cash	(3,661)	5,830
Cash and restricted cash at beginning of period	6,461	631
Cash and restricted cash at end of period	\$ 2,800	\$ 6,461
Cash	\$ 2,567	\$ 6,057
Restricted cash	233	404
Cash and restricted cash	\$ 2,800	\$ 6,461
Supplemental Non-Cash Disclosures:		
Payments made on line of credit from proceeds of the sale	\$ -	\$ (1,348)
Principal reduction on subordinated secured promissory note	\$ -	\$ 60
Dividends on investment in affiliate	\$ 150	\$ -

The accompanying notes are an integral part
of the consolidated financial statements.

HG HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Significant Accounting Policies

Organization and Basis of Presentation

HG Holdings, Inc.'s the ("Company") consolidated financial statements are prepared in accordance with accounting principles generally accepted in the U.S. ("GAAP"). The consolidated financial statements include the accounts of all subsidiaries and affiliates in which the Company holds a controlling financial interest as of the financial statement date. All subsidiaries were sold to Stanley Furniture Company, LLC, formerly Churchill Downs, LLC, in the Asset Sale effective March 2, 2018. As of each balance sheet date, the Company did not have any subsidiaries which are consolidated.

On March 2, 2018, we sold substantially all of our assets (the "Asset Sale") to Stanley Furniture Company LLC, formerly Churchill Downs LLC ("Buyer"), pursuant to the terms of the Asset Purchase Agreement, dated as of November 20, 2017, as amended by the First Amendment thereto dated January 22, 2017 (the "Asset Purchase Agreement"). Operations of the furniture business from January 1, 2018 through March 2, 2018 are reflected as discontinued operations pursuant to the provisions of Accounting Standards Codification 2015-20, *Presentation of Financial Statements – Discontinued Operations* for all periods presented. Results of discontinued operations are excluded from the accompanying notes to the consolidated financial statements for all periods presented, unless otherwise noted. As a result of the sale, on March 2, 2018, the Company's Board of Directors approved an amendment to the Company's Restated Certificate of Incorporation to change the name of the Company to HG Holdings, Inc. The amendment became effective upon the filing of a Certificate of Amendment with the Secretary of State of the State of Delaware on March 2, 2018.

As a result of the Asset Sale, the Company had no revenue-generating operations. On March 19, 2019, we purchased 300,000 shares of HC Realty's Common Stock (the "HC Common Stock") for an aggregate purchase price of \$3,000,000 and 200,000 shares of HC Realty's 10.00% Series B Cumulative Convertible Preferred Stock (the "HC Series B Stock") for an aggregate purchase price of \$2,000,000. As a result of these purchases, we currently own approximately 16.4% of the as-converted equity interest of HC Realty. Also on March 19, 2019, we, together with certain other lenders, including certain entities affiliated with HPCM (collectively, the "Lenders"), entered into a loan agreement (the "Loan Agreement") with HC Realty's operating partnership, and HCM Agency, LLC, as collateral agent (the "Agent"), pursuant to which the Lenders provided HC Realty's operating partnership with a \$10,500,000 senior secured term loan (the "Initial Term Loan"), of which \$2,000,000 was provided by us. The Agent is affiliated with HPCM. As a result of these investments, our sources of income include dividends on HC Realty Series B Stock, interest earned on the loan we made to HC Realty's operating partnership, and interest paid on cash and subordinated secured promissory notes. The Company believes that the revenue generating from these sources in addition to the cash on hand is sufficient to fund operating expenses for at least 12 months from the date of these consolidated financial statements. The Company previously disclosed its board was considering a rights offering of the Company's common stock to existing stockholders to raise additional cash for acquisitions. On December 16, 2019, the Company filed a registration statement with respect to a proposed rights offering of up to 19.5 million shares of its Common Stock (the "Rights Offering"). The Rights Offering will be commenced only following effectiveness of the registration statement relating to the Rights Offering and will be made only by means of a prospectus. The Company anticipates using the proceeds of the Rights Offering for acquisitions, including purchasing additional HC Series B Stock, HC Common Stock or debt of HC Realty.

Certain amounts in the 2018 consolidated financial statements have been reclassified to conform to 2019 presentation. These reclassifications do not have an impact on the consolidated statements of operations or the consolidated statement of comprehensive income (loss).

Cash

We consider all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Restricted Cash

Restricted cash includes collateral deposits required under the Company's letter of credit agreement, which expires in June 2020, to guarantee the Company's workers compensation insurance policy. The restricted cash balance is expected to mature over the next six months. As of December 31, 2019, there was no outstanding balance on the letter of credit agreement.

Concentration of Credit Risk

The Company place its cash and restricted cash with financial institutions and, at times, cash held in depository accounts may exceed the Federal Deposit Insurance Corporation insured limit.

Revenue Recognition

Revenue, prior to the Asset Sale, was recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. To achieve this principle, the Company performed the following five steps: (i) identification of a contract with a customer; (ii) identification of any separate performance obligation; (iii) determination of the transaction price; (iv) allocation of the transaction price to the performance obligation in the contract, if any; and (v) recognition of revenue when the Company had satisfied the underlying performance obligation if any. The Company recognized substantially all of its revenue at a point in time when control of the Company's goods was passed to the customer, which typically occurs upon shipment, with the exception of consigned goods. The Company considered its performance obligation satisfied at the time this control was transferred. Customer payment terms for these shipments typically ranged between 30- and 90-days. The Company elected to treat shipping and handling performed after control has transferred to customers as a fulfillment activity, and additionally, elected the practical expedient to report sales taxes on a net basis. The Company recorded shipping and handling expense related to product sales as cost of sales.

Interest Income

Interest income is recorded on an accrual basis based on the effective interest rate method and includes the accretion of fair value adjustments/discounts. Fair value adjustments to par value are accreted/amortized into interest income over the life of the respective security using the effective yield method. The amortized cost of investments represents the original cost adjusted for the accretion of fair value adjustments, if any.

Other revenues are recognized when contractual obligations are fulfilled or as services are provided.

Payment-in-Kind Interest

The Company has subordinated secured notes receivables that may contain payment-in-kind ("PIK") provisions. The PIK interest, computed at the contractual rate specified in the loan agreement, is added to the principal balance of the loan and recorded as interest income.

Variable Interest Entities

As a result of both the Asset Sale and the S&L Asset Sale, we have a variable interest in three entities that have been determined to be variable interest entities ("VIE"). If we conclude that we are the primary beneficiary of a VIE, we are required to consolidate it. To determine if we are the primary beneficiary, we evaluate whether we have the power to direct the activities that most significantly impact the VIE's economic performance and the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. Our evaluation includes identification of significant activities and an assessment of our ability to direct those activities based on governance provisions and arrangements to provide or receive product and process technology, product supply, operations services, equity funding, financing, and other applicable agreements and circumstances. Our assessments of whether we are the primary beneficiary of our VIE requires significant assumptions and judgments. We have concluded that we are not the primary beneficiary of the three VIEs as we do not have the power to direct the activities that most significantly impact the VIEs' economic performance and therefore are not required to consolidate these entities.

Subordinated Notes Receivable

In accordance with ASC 810-40-5, upon the sale of substantially all of the assets the Company recorded a gain on the deconsolidation of a group of assets based on the difference between the fair value of the consideration received and the carrying amount of the group of assets. As the Original Note was part of the consideration received, the Company recorded the Original Note at its fair value on March 2, 2018. The fair value of the Original Note was estimated using discounted cash flow analyses, using market rates at the acquisition date that reflect the credit and inherent rate-risk inherent in the Original Note. The discount resulting from the fair value adjustment was recorded as a direct reduction to the original principal balance and amortized to interest income using the effective interest method. As of the date of the assignment and transfer from the Buyer to S&L, it was determined that the Original Note was extinguished and therefore both the A&R Note and the S&L Note were measured based on their fair value in accordance with Emerging Issues Task Force (EITF) – *Creditors Accounting for Modification or Exchange of Debt Instruments*. The discounts resulting from the fair value adjustments for the A&R Note and the S&L Note were recorded as a direct reduction to the original principal balance and amortized to interest income using the effective interest method. When impairment is determined to be probable, the measurement will be based on the fair value of the collateral securing the notes. The determination of impairment involves management's judgment and the use of market and third-party estimates regarding collateral values. During 2019 management determined that the Second A&R note was other than temporarily impaired and recorded an impairment loss of \$897,000.

Property, Plant and Equipment

Depreciation of property, plant and equipment is computed using the straight-line method based upon the estimated useful lives. Depreciation expense is charged to general and administrative expenses. Gains and losses related to dispositions and retirements are included in income. Maintenance and repairs are charged to expense as incurred; renewals and betterments are capitalized. Assets are reviewed for possible impairment when events indicate that the carrying amount of an asset may not be recoverable. Assumptions and estimates used in the evaluation of impairment may affect the carrying value of property, plant and equipment, which could result in impairment charges in future periods. Our depreciation policy reflects judgments on the estimated useful lives of assets. Our long-lived assets were tested for impairment at December 31, 2019 and determined that the long-lived assets were not impaired.

Cost Method Investments

The Company held, at December 31, 2018, a 1.4% equity interest in Churchill Downs Holdings, Ltd. (“Churchill”), a British Virgin Island business company which it received as a partial consideration for the sale of substantially all of our assets. As a result of additional equity capital contributions to Churchill during the fourth quarter 2018, HG Holdings equity interest was diluted from its original 5% ownership interest. Long-term investments consist of investments in equity securities of nonpublic entities without readily determinable fair values. These investments are classified in “Investment in closely held company” on the consolidated balance sheets. The company determines the appropriate classifications of its investment(s) at the acquisition date. Upon adoption of ASU 2016-01, the Company carries its long-term investment at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transaction for the identical or a similar investment of the same issuer. The Company reviews its equity securities without readily determinable fair values on a regular basis to determine if the investment is impaired. For purposes of this assessment, the Company considers the investee’s cash position, liquidity, earnings and revenue outlook, equity position, and ownership, among other factors, in its review. If management’s assessment indicates that an impairment exists, the Company estimates the fair value of the equity investment and recognizes in current earnings an impairment loss that is equal to the difference between the fair value of the equity investment and its carrying amount. During the year ended December 31, 2019, the Company sold its equity interest back to Churchill for \$120,000 for which the Company had determined during the year ended December 31, 2018 the fair value to be zero. Accordingly, the Company recorded a gain on sale of \$120,000.

Income Taxes

Deferred income taxes are determined based on the difference between the consolidated financial statement and income tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. Deferred tax expense represents the change in the deferred tax asset/liability balance. Income tax credits are reported as a reduction of income tax expense in the year in which the credits are generated. A valuation allowance is recorded when it is more likely than not that a deferred tax asset will not be realized. Interest and penalties on uncertain tax positions are recorded as income tax expense.

Fair Value of Financial Instruments

Accounting for fair value measurements requires disclosure of the level within the fair value hierarchy in which fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3). The fair value of receivables and payables approximate the carrying amount because of the short maturity of these instruments.

Earnings per Common Share

Basic earnings per share is computed based on the weighted average number of common shares outstanding. Diluted earnings per share includes any dilutive effect of outstanding stock options and restricted stock calculated using the treasury stock method.

Stock-Based Compensation

We record share-based payment awards at fair value on the grant date of the awards, based on the estimated number of awards that are expected to vest, over the vesting period. The fair value of stock options was determined using the Black-Scholes option-pricing model. The fair value of the restricted stock awards was based on the closing price of the Company's common stock on the date of the grant. For awards with performance conditions, we recognize compensation cost over the expected period to achieve the performance conditions, provided achievement of the performance conditions are deemed probable.

Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Changes in such estimates may affect amounts reported in future periods.

New Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* ("ASU 2016-13"). The amendments in ASU 2016-13 require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendment is effective for public entities for annual reporting periods beginning after December 15, 2019, however early application is permitted for reporting periods beginning after December 15, 2018. The Company does not anticipate the adoption of ASU 2016-13 to have a material impact to the consolidated financial statements.

In February 2016, the FASB issued its final lease accounting standard, ASC, *Leases (Topic 842)* ("ASU 2016-02"), which requires lessees to recognize a right-of-use asset and a lease liability for virtually all of their leases (other than leases that meet the definition of a short-term lease). The lease liability will be equal to the present value of lease payments and the right-of-use asset will be based on the lease liability, subject to adjustment such as for initial direct costs. For income statement purposes, the new standard retains a dual model similar to ASC 840, requiring leases to be classified as either operating or finance. For lessees, operating leases will result in straight-line expense (similar to current accounting by lessees for operating leases under ASC 840) while finance leases will result in a front-loaded expense pattern (similar to current accounting by lessees for capital leases under ASC 840). The Company adopted the standard effective January 1, 2019. As of December 31, 2019, we do not have any long-term leases. We will evaluate the effect that ASU 2016-02 will have on our consolidated financial statements and related disclosures at such time a long-term lease is executed. Our only lease as of December 31, 2019 relates to a real estate lease for the corporate office space. The adoption did not have material impact to the consolidated financial statements.

2. Discontinued Operations

On March 2, 2018, we sold substantially all of our assets (the "Asset Sale") to Churchill Downs LLC ("Buyer"), pursuant to the terms of the Asset Purchase Agreement, dated as of November 20, 2017, as amended by the First Amendment thereto dated January 22, 2018 (the "Asset Purchase Agreement"). Operations of the furniture business from January 1, 2018 through March 2, 2018 are reflected as discontinued operation pursuant to the provisions of Accounting Standards Codification 2015-20, *Presentation of Financial Statements – Discontinued Operations* for all periods presented.

Loss from discontinued operations, net of taxes, comprised the following for the twelve months ended December 31, 2019 and 2018 (in thousands):

	Twelve Months Ended	
	Dec. 31, 2019	Dec. 31, 2018
Net sales	\$ -	\$ 6,787
Cost of sales	-	(6,485)
Selling, general and administrative expenses	-	(2,448)
Loss on sale of assets	-	(865)
Loss from discontinued operations before income taxes	-	(3,011)
Income tax benefit	-	-
Loss from discontinued operations, net of taxes	<u>\$ -</u>	<u>\$ (3,011)</u>

Included in selling, general and administrative expenses incurred for the twelve months ended December 31, 2018 were certain transaction costs including investment banking fees, legal fees, and other transaction costs directly attributable to the Asset Sale.

3. Property, Plant and Equipment

	Depreciable lives (in years)	(in thousands)	
		2019	2018
Computers and equipment	3 to 7	\$ 7	\$ 7
Furniture and fixtures	5 to 7	3	3
Property, plant and equipment, at cost		<u>10</u>	<u>10</u>
Less accumulated depreciation		3	1
Property, plant and equipment, net		<u>\$ 7</u>	<u>\$ 9</u>

4. Subordinated Notes Receivable

The Company received a \$7.4 million subordinated secured promissory note (the "Original Note") from the Buyer as partial consideration for the sale of substantially all of our assets during the first quarter of 2018. On September 6, 2018, the Buyer sold certain of its assets, including certain inventory and the Stone & Leigh tradename (the "S&L Asset Sale") to Stone & Leigh, LLC ("S&L"), which is owned by a group which includes Matthew W. Smith, the Company's former interim Chief Executive Officer. As a part of the S&L Asset Sale, the Buyer assigned to S&L certain of its rights and obligations under the original \$7.4 million subordinated secured promissory note. In connection with the assignment, the Company entered into an Amended and Restated Subordinated Secured promissory note with the Buyer (the "A&R Note") and a new Subordinated Secured Promissory Note with S&L (the "S&L Note"). The A&R Note had a principal amount as of the assignment date of \$3.3 million.

On February 7, 2019, the Company, Buyer and related parties entered into a Consent, Reaffirmation, and Joinder (the "Consent") in connection with a new senior credit facility that Buyer expected to enter into with Alterna Capital Solutions, LLC ("Alterna"). Pursuant to the Consent, Buyer delivered a Seconded Amended and Restated Subordinated Secured Promissory Note (the "Second A&R Note") in favor of the Company. The Second A&R Note has a principal amount of \$3.2 million and remains payable no later than March 2, 2023, at which time the total principal amount is due. Interest on the principal balance of the note continues to accrue daily at an annual fixed rate of 6%. The other terms of the Second A&R Note are substantially the same as those of the A&R Note. The Second A&R Note also remains guaranteed by Stanley Intermediate Holdings LLC, formerly Churchill Downs Intermediate Holdings LLC. Pursuant to the Consent, Buyer's British Virgin Island parent company has also guaranteed the Second A&R Note.

On February 25, 2019, Buyer closed and funded its new senior credit facility with Alterna. Pursuant to the Consent, the Company entered into an Intercreditor and Debt Subordination Agreement, dated February 25, 2019 (the "Subordination Agreement"), with Alterna. The Subordination Agreement with Alterna is generally on the same terms as the subordination agreement the Company previously entered into with North Mill Capital, LLC in connection with the original subordinated secured promissory note dated March 2, 2018 from Buyer in favor of the Company, except that principal payments on the Second A&R Note, before satisfaction of the of indebtedness to Alterna and termination of the Subordination Agreement, are conditioned upon (1) no event of default under the new senior credit facility existing or resulting from the payment, (2) availability under the new senior credit facility to make the payment, (3) all tax and debt obligations of Stanley Furniture Company, LLC ("SFC") being current and within their terms, and (4) there being no delinquency in payables or other obligations of SFC to specified critical vendors. Cash interest payments of \$141,000 and \$35,000 were received during the years ending December 31, 2019 and 2018, respectively.

Despite Buyer paying interest quarterly in advance on the Second A&R Note, the Company concluded, based on current information and events in the Buyer's business, that the Company did not believe it would be able to collect the amount due according to the Second A&R Note and determined that the note was other than temporarily impaired. The evaluation was generally based on an assessment of the borrower's financial condition and the adequacy of the collateral securing the Second A&R Note. Given the facts and circumstances, the Company recorded an impairment loss of \$897,000 in the second quarter of 2019 resulting in the carrying value of the A&R Note decreasing to \$1.3 million as of June 30, 2019. On August 21, 2019, the Company delivered a notice of default to Buyer under the Second A&R Note. The Company delivered this notice after receiving information from Alterna that Buyer was presently in default under its credit facility with Alterna.

The Company entered into a Forbearance Agreement (the "Forbearance Agreement") with Buyer and certain affiliates (the "Loan Parties") pursuant to which the Company has agreed to forbear from exercising its rights and remedies under the Second A&R Note until February 24, 2020 or earlier in the event of (i) a default occurring under the Second A&R Note other than previous defaults acknowledged in the Forbearance Agreement or (ii) a breach of the Forbearance Agreement by the Loan Parties.

The Forbearance Agreement became effective on November 1, 2019 (the "Effective Date") when Buyer paid the Company \$220,000 and certain other conditions were satisfied. Under the Forbearance Agreement, Buyer has also agreed to pay the Company \$200,000 on or before the 30th day following the Effective Date, \$150,000 on or before the 60th day following the Effective Date, and \$130,000 on or before the 90th day following the Effective Date. The payment made on November 1, 2019 and each of the following payments are referred to as a Forbearance Period Payment and will be applied to the outstanding principal balance of the Note. As of December 31, 2019, the Company received the principal payments on the effective date, the 30th day, and the 60th day, totaling \$570,000, in accordance with the Forbearance Agreement.

Under the Forbearance Agreement, the Company has agreed to accept the discounted payments in satisfaction of the Second A&R Note if the forbearance period has not been terminated: (i) on or before the 90th day after the Effective Date, \$2,230,000 less the sum of all Forbearance Period Payments and payments made to cure a minimum collateral value shortfall and (ii) after the 90th day following the Effective Date, \$2,530,000 less Forbearance Period Payments and payments made to cure a minimum collateral value shortfall.

The Forbearance Agreement also includes customary representations and warranties of Loan Parties and certain releases by Loan Parties.

All amounts outstanding under the Ledgered Asset Based Lending Agreement between Alterna Capital Solutions, LLC ("Alterna") and Buyer have been paid in full and the Intercreditor and Debt Subordination Agreement, dated February 25, 2019, executed by the Company in favor of Alterna is no longer effective.

In view of the impairment loss recorded by the Company in the second quarter of 2019 with respect to the Note, the Company does not anticipate recording any additional impairment charges at this time as a result of the Event of Default or the Forbearance Agreement. As of December 31, 2019, the outstanding principal amount of the Second A&R Note was \$2.6 million and the carrying value of the Note was \$709,000.

The S&L Note had a principal amount of \$4.4 million as of the assignment date. The S&L Note also matures on March 2, 2023, at which time the total principal amount is due. Interest on the S&L Note accrues at a fixed rate of 10% per annum. Cash interest payments of \$356,000 and \$141,000 were received during the years ending December 31, 2019 and 2018, respectively. During the years ending December 31, 2019 and 2018, respectively, the Company received \$1,011,000 and \$60,000 of principal payments on the S&L Note.

At the assignment date, the Company evaluated the fair value of the S&L Note. The Company recorded accreted interest income on the fair value adjustment of the S&L Note of \$162,000 and \$62,000 for years ending December 31, 2019 and 2018, respectively. Resulting from the accretion of the fair value discount and the principal payments, the outstanding principal amount of the S&L Note was \$3.3 million and the carrying amount was \$2.7 million as of December 31, 2019.

A reconciliation of the activity in the Second A&R Note for the years ending December 31, 2019 and 2018 is as follows (in thousands):

	Principal	Discount	Balance
Balance at January 1, 2018	\$ -	\$ -	\$ -
New borrowings on subordinated note receivables	7,421	(2,607)	4,814
Interest paid-in-kind	337	-	337
Extinguishment of debt	(4,400)	1,330	(3,070)
Capitalized legal fees	18	-	18
Accretion of discount	-	265	265
Balance at December 31, 2018	\$ 3,376	\$ (1,012)	\$ 2,364
Principal payments	(812)	-	(812)
Impairment	-	(897)	(897)
Accretion of discount	-	54	54
Balance at December 31, 2019	<u>\$ 2,564</u>	<u>\$ (1,855)</u>	<u>\$ 709</u>

A reconciliation of the activity in the S&L Note for the years ending December 31, 2019 and 2018 is as follows (in thousands):

	Principal	Discount	Balance
Balance at January 1, 2018	\$ -	\$ -	\$ -
New borrowings on subordinated note receivables	4,400	(884)	3,516
Principal payments	(60)	-	(60)
Accretion of discount	-	62	62
Balance at December 31, 2018	\$ 4,340	\$ (822)	\$ 3,518
Principal payments	(1,011)	-	(1,011)
Accretion of discount	-	163	163
Balance at December 31, 2019	<u>\$ 3,329</u>	<u>\$ (659)</u>	<u>\$ 2,670</u>

5. Loan to Affiliate

On March 19, 2019, the Company, together with certain other Lenders, entered into a loan agreement (the "Loan Agreement") with HC Realty's operating partnership, and HCM Agency, LLC, as collateral agent (the "Agent"), pursuant to which the Lenders provided HC Realty's operating partnership with a \$10,500,000 senior secured term loan (the "Initial Term Loan"), of which \$2,000,000 was provided by the Company.

The Loan Agreement matures on March 19, 2022. Interest on the Loan Agreement accrues at a rate of 14% per annum. Interest earned for the year ended December 31, 2019 was \$223,000.

6. Investment in Affiliate

On March 19, 2019, the Company entered into subscription agreements with HC Realty, pursuant to which it purchased (i) 200,000 shares of HC Realty's 10.00% Series B Cumulative Convertible Preferred Stock (the "Series B Stock") for an aggregate purchase price of \$2,000,000 and (ii) 300,000 shares of HC Realty's common stock for an aggregate purchase price of \$3,000,000. Certain investors affiliated with HPCM purchased an additional 850,000 shares of Series B Stock for an aggregate purchase price of \$8,500,000. While some of these investors have other investments with HPCM, each of these investors made a separate and direct investment in HC Realty and HPCM does not receive management fees, performance fees, or any other economic benefits with respect to these investors' investment in HC Realty's Series B Stock.

The Series B Stock is not deemed to be in-substance common stock and is accounted for using the measurement alternative for equity investments with no readily determinable fair value. The Series B Stock will be reported at cost, adjusted for impairments or any observable price changes in ordinary transactions with identical or similar investments issued by HC Realty.

The following table summarizes the Company's investment in HC Realty as of the two years ended December 31, 2019 (in thousands):

	Ownership %		Investment in Affiliate Balance		Loss recorded in the Consolidated Statements of Operations (b)	
	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018	2019	2018
	HC Realty Series B Stock (a)	7.9%	0.0%	\$ 2,000	-	\$ -
HC Realty common stock	8.5%	0.0%	2,405	-	(430)	-
Total	16.4%	0.0%	\$ 4,405	-	\$ (430)	-

- (a) Represents investments in shares of HC Realty preferred stock with a basis of \$2 million. Each share of preferred stock can be converted into one share of HC Realty common stock at a conversion price equal to the lesser of \$9.10 per share or the fair market value per share of HC Realty common stock, subject to adjustment upon the occurrence of certain events.
- (b) Loss from these investments is included in "Loss from affiliate" in the consolidated statement of operations. Since HC Realty is a Real Estate Investment Trust and not a taxable entity, the loss is not reported net of taxes.

The Company's investment in HC Realty common stock is accounted for under the equity method of accounting. The company determined that accounting for under the equity method was appropriate even though the Company owns less than 20% of the fully diluted shares outstanding because the Company holds significant influence of HC Realty.

7. Income Taxes

The provision for income tax (benefit) expense consists of (in thousands):

	2019	2018
Current:		
Federal	\$ -	\$ -
State	(84)	(213)
Total current	(84)	(213)
Deferred:		
Federal	-	(989)
State	-	-
Total deferred	-	(989)
Income tax (benefit) expense from continuing operations	\$ (84)	\$ (1,202)

A reconciliation of the difference between the federal statutory income tax rate and the effective income tax rate follows:

	2019	2018
Federal statutory rate	21.0%	21.0%
State tax, net of federal benefit	3.8	2.3
State tax credits and adjustments	(122.7)	(11.8)
Change in federal tax rate	-	-
Alternative minimum tax	-	67.7
Valuation allowance increase	(3.9)	(11.5)
Other, net	4.3	14.5
Effective income tax rate	<u>(97.6) %</u>	<u>82.2%</u>

We have completed our analysis of the income tax effects of the Tax Act and recorded all final adjustments during 2018. As noted previously, the Tax Act repeals the corporate alternative minimum tax, or AMT, regime, including claiming a refund and full realization of remaining AMT credits. During 2018, we further analyzed the nature, validity, and recoverability of the AMT-related deferred tax credit carryforwards and recorded a tax benefit of \$988,000 for the credits that will be refundable in future years.

The income tax effects of temporary differences that comprise deferred tax assets and liabilities at December 31 follow (in thousands):

	2019	2018
Noncurrent deferred tax assets (liabilities):		
Equity method investment	\$ 99	\$ -
Other accrued expenses	32	50
Property, plant and equipment	(1)	(1)
Notes receivable fair value adjustment	578	413
Employee benefits	66	95
AMT credit	247	698
Net operating loss	7,726	7,743
Gross non-current deferred tax assets	8,747	8,998
Less valuation allowance	(8,500)	(8,504)
Net noncurrent deferred tax assets	<u>\$ 247</u>	<u>\$ 494</u>

We have U.S. federal net operating loss carryforwards of approximately \$33.8 million which are available to reduce future taxable income. The federal net operating loss will begin expiring in 2033. We have combined state net operating loss carryforwards of \$24.1 million that will expire at various times beginning in 2027.

During 2019, we recorded a non-cash credit to our valuation allowance of approximately \$4,000 against our December 31, 2019 deferred tax assets. The primary assets which are covered by this valuation allowance are employee benefits and net operating losses in excess of the amounts which can be carried back to prior periods. The valuation allowance was calculated in accordance with the provisions of ASC 740, *Income Taxes*, which requires an assessment of both positive and negative evidence when measuring the need for a valuation allowance. Our results over the most recent four-year period were heavily affected by our business restructuring activities. Our cumulative loss represented sufficient negative evidence to require a valuation allowance. We intend to maintain a valuation allowance until sufficient positive evidence exists to support its reversal, resulting in no deferred tax asset balance being recognized. Should we determine that we will not be able to realize all or part of our deferred tax asset in the future, an adjustment to the deferred tax asset will be charged to income in the period such determination is made.

The unrecognized tax benefits activity for the year ended December 31 follows (in thousands):

	2019	2018
Unrecognized tax benefits balance at January 1	\$ 241	\$ 454
Gross decrease in tax positions of prior years	(84)	(213)
Unrecognized tax benefits balance at December 31	<u>\$ 157</u>	<u>\$ 241</u>

As of December 31, 2019 and 2018, we had approximately \$23,000 and \$34,000 of accrued interest related to uncertain tax positions, respectively.

Total amount of unrecognized tax benefits that would affect our effective tax rate if recognized is \$124,000 at December 31, 2019 and \$190,000 at December 31, 2018. The 2011 through 2017 tax years remain open to examination by major taxing jurisdictions.

8. Stockholders' Equity

In addition to common stock, authorized capital includes 1,000,000 shares of "blank check" preferred stock. None was outstanding during the two years ended December 31, 2019. The Board of Directors ("Board") is authorized to issue such stock in series and to fix the designation, powers, preferences, rights, limitations and restrictions with respect to any series of such shares. Such "blank check" preferred stock may rank prior to common stock as to dividend rights, liquidation preferences or both, may have full or limited voting rights and may be convertible into shares of common stock.

Basic and diluted earnings per share are calculated using the following share data (in thousands):

	2019	2018
Weighted average shares outstanding for basic calculation	14,507	14,531
Dilutive effect of restricted stock	430	43
Weighted average shares outstanding for diluted calculation	14,937	14,574

For the years ended December 31, 2019 and 2018, approximately 42,000 and 225,000 stock awards, respectively, were excluded from the diluted per share calculation as they would be anti-dilutive.

From time to time, we will repurchase common shares that are tendered by recipients of restricted stock awards to satisfy tax withholding obligations on vested restricted stock. There were no repurchases during 2019. During 2018, we repurchased 46,643 shares for approximately \$30,000.

In July 2012, the Board authorized the purchase of up to \$5.0 million of our common stock. These repurchases may be made from time to time in the open market, in privately negotiated transactions, or otherwise, at prices the Company deems appropriate. No repurchases of our common stock were made in 2019. During 2018, we repurchased 221,121 shares of common stock for approximately \$133,000. The Board does not intend to repurchase any additional shares of our common stock under this authorization.

In the fourth quarter of 2016, the Board adopted a Rights Agreement designed to protect the Company's substantial net operating loss carryforwards. Under the Rights Agreement, company stockholders of record as of December 15, 2016 received one preferred share purchase right for each share of common stock they owned on such date. If a person or group acquires beneficial ownership of 4.9% or more of the Company's outstanding common stock (subject to certain specified exceptions), the rights will become exercisable. The rights will also become exercisable if a person or group that already owns 4.9% or more of the Company's outstanding common stock acquires an additional 1% or more of the Company's outstanding common stock.

The Company entered into Amendment No. 1, dated January 30, 2017, to the Rights Agreement. This amendment amends the definition of Acquiring Person in the Rights Agreement to exclude any member of the Hale Group (Hale Partnership Fund, LP and certain affiliates that are parties to the agreement (Hale Agreement) dated January 30, 2017 with the Company), provided that any purchases made by members of the Hale Group after December 5, 2016 are made in compliance with Section 1(h) of the Hale Agreement. The Company entered into Amendment No 2, dated December 5, 2019, to the Rights Agreement. This amendment amends the definition of "Expiration Time" to provide that, unless otherwise expiring under the terms of the existing definition, the Rights Agreement will expire (i) at the close of business on the day after the Company's 2020 annual meeting of stockholders unless the Company's stockholders approve the amendment to the definition of "Expiration Time" in this amendment or (ii) the close of business on December 5, 2022 (unless the Company's NOLs are utilized prior to that date).

If the rights become exercisable, all holders of rights, other than the person or group triggering the rights, will be entitled to purchase Company common stock at a 50% discount. Rights held by the person or group triggering the rights will become void and will not be exercisable. The rights have a de minimis fair value and trade with the Company's common stock. The Board may amend the Rights Agreement in any way or redeem the rights at any time unless and until the rights are triggered.

The Rights Agreement includes a procedure for the Board to consider requests to exempt a particular transaction from triggering the exercisability of the rights under the Rights Agreement if the transaction (i) does not (x) create a significant risk of the Company's NOLs being impaired or (y) constitute a default under the change-in-control covenant included in the Company's credit facility or (ii) is otherwise in the best interests of the Company.

9. Stock Based Compensation

The Stanley Furniture Company, Inc. 2012 Incentive Compensation Plan (Incentive Compensation Plan) provides for the granting of performance grants, performance shares, stock options, restricted stock, restricted stock units, and stock appreciation rights to employees and certain service providers. Under this plan, the aggregate number of common shares that may be issued through awards of any form is 1.6 million. In addition, shares authorized under the 2008 Incentive Compensation Plan are also available for issuance under the Incentive Compensation Plan if they are unissued or subsequently expire, are forfeited or terminate unexercised. As of December 2019, there are 1.2 million shares remaining available for future issuance under equity compensation plans.

Stock Options

The options are issued at market value on the date of grant and have a term of 10 years from the grant date. In general, employee grants vest ratably over a four to five-year period and Director grants vest after one year. The fair value of each option is amortized into compensation expense on a straight-line basis between the grant date for the option and each vesting date. We have estimated the fair value of all stock option awards as of the date of the grant by applying the Black-Scholes pricing valuation model.

The application of this valuation model involves assumptions that are judgmental and sensitive in the determination of compensation expense. No options were granted in 2019 or 2018.

Stock option activity for the two years ended December 31, 2019, follows:

	Number of shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2018	826,582	\$ 5.35	2.8	
Cancelled/Forfeited	(763,385)	5.28		
Outstanding at December 31, 2018	63,197	\$ 7.01	1.8	
Expired	(20,914)	8.64		
Outstanding at December 31, 2019	42,283	\$ 6.20	0.8	\$ -
Exercisable at December 31, 2019	42,283	\$ 6.20	0.8	\$ -

There were no stock options exercised in 2019 and 2018.

Restricted Stock

The restricted stock awards are accounted for as “non-vested equity shares” until the awards vest or are forfeited. In general, restricted stock awards for employees are time vested or performance vested and for non-employee directors vest at the end of their current term on the Board. The fair value of each share of restricted stock is the market price of our stock on the grant date. The fair value of each time vested award is amortized into compensation expense on a straight-line basis between the award date and the vesting date. Performance based awards are amortized into stock compensation expense based on the probability of meeting the performance criteria. In 2019 and 2018, 30,354 and 182,732 of restricted stock awards vested and were released, respectively.

The following table summarizes information about restricted stock awards for the two years ended December 31, 2019:

	Number of shares	Weighted- Average Grant Date Fair Value
Outstanding at January 1, 2018	327,283	\$ 1.82
Vested	(182,732)	2.02
Granted	161,290	0.62
Cancelled/Forfeited/Expired	(101,266)	1.55
Outstanding at December 31, 2018	204,575	\$ 0.83
Vested	(30,354)	1.81
Granted	416,666	0.60
Cancelled/Forfeited/Expired	(161,290)	0.62
Outstanding at December 31, 2019	429,597	\$ 0.61

As of December 31, 2019, there was \$207,000 of total unrecognized compensation cost related to non-vested restricted stock awards, which is expected to be recognized over a weighted-average remaining vesting period of 2.5 years.

10. Income for Continued Dumping and Subsidy Offset Act (CDSOA)

The CDSOA provides for distribution of monies collected by U.S. Customs and Border Protection (Customs) for imports covered by antidumping duty orders entering the United States through September 30, 2007 to qualified domestic producers. In 2019 and 2018, we received \$1.2 million and \$26,000, respectively, in distributions of funds collected on antidumping duty orders entering the United States prior to September 2007.

11. Commitments and Contingencies

Our leased facility includes our corporate office space. The lease for office space is month to month. Rental expense charged to operations was \$29,000 and \$12,000 in 2019 and 2018, respectively.

We currently have letters of credit to cover estimated exposures, most notably with workman’s compensation claims. This agreement requires us to maintain a compensating balance with the issuer for the amounts outstanding. We currently have letters of credit outstanding in the amount of \$230,000. The compensating balance amount is reflected as restricted cash on the consolidated balance sheet.

In the normal course of business, we are involved in claims and lawsuits, none of which currently, in management’s opinion, will have a material adverse effect on our Consolidated Financial Statements.

12. Subsequent Events

On October 31, 2019, the Company entered into a Forbearance Agreement with the Loan Parties pursuant to which the Company agreed, subject to certain conditions, to forbear until February 24, 2020 from exercising its rights and remedies under the Second A&R Note issued by Buyer to the Company. On February 24, 2020, the Company and the Loan Parties entered into a letter agreement (the “Forbearance Extension Letter Agreement”) extending the outside termination date for the forbearance period under the Forbearance Agreement from February 24, 2020 to February 26, 2020. The other terms and conditions of the Forbearance Agreement remain the same. The forbearance period terminated on February 26, 2020 under the terms of the Forbearance Extension Letter Agreement and Forbearance Agreement.

The Company received prepayments on February 28, 2020 and March 4, 2020 of \$200,000 and \$350,000, respectively, of the principal amount on the Second A&R Note from the Buyer.

On March 6, 2020, the Company and the Loan Parties entered into a letter agreement (the “Second Forbearance Extension Letter Agreement”) extending, subject to certain conditions, the outside termination date from February 26, 2020 to March 17, 2020. The extension of the outside termination and the effectiveness of the Second Forbearance Extension Letter Agreement is conditioned on Buyer making payments to be applied to the outstanding principal balance of the Second A&R Note of \$250,000 on or before March 12, 2020 and \$750,000 on or before March 13, 2020. The Second Forbearance Extension Letter Agreement also requires the Buyer to make an additional \$391,970 payment on or before March 17, 2020 which will be applied to the outstanding principal balance of the Second A&R Note. The other terms and conditions of the Forbearance Agreement remain the same.

On March 12, 2020, the Company received payment from Buyer of \$250,000 pursuant to the Second Forbearance Extension Letter Agreement.

HG HOLDINGS, INC.
SCHEDULE II – VALUATION AND QUALIFYING ACCOUNTS
For each of the Two Years in the Period Ended December 31, 2019
(in thousands)

Column A	Column B	Column C	Column D	Column E
Descriptions	Balance at Beginning of Period	Charged (Credited) to Costs & Expenses	Deductions	Balance at End of Period
2019				
Doubtful receivables	\$ -	\$ -	\$ -	\$ -
Discounts, returns, and allowances	-	-	-	-
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
2018				
Doubtful receivables	\$ 96	\$ -	\$ 96(a)	\$ -
Discounts, returns, and allowances	107	-	107(a)	-
	<u>\$ 203</u>	<u>\$ -</u>	<u>\$ 203</u>	<u>\$ -</u>

(a) Uncollectible receivables and reserves for discounts, returns, and allowances were disposed of in the Asset Sale on March 2, 2018

DESCRIPTION OF THE COMPANY'S SECURITIES REGISTERED PURSUANT TO SECTION 12 OF THE SECURITIES EXCHANGE ACT OF 1934

HG Holdings, Inc. ("we," "us," "our," "HG Holdings" or the "Company") has two classes of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended: (i) our common stock, par value \$.02 per share and (ii) our Preferred Stock Purchase Rights. The following description of our common stock and Preferred Stock Purchase Rights is a summary and is qualified in its entirety by reference to our restated certificate of incorporation and bylaws, which are incorporated by reference as exhibits to the Annual Report on Form 10-K of which this exhibit is a part. You are encouraged to read our Certificate of Incorporation and By-Laws, as well as applicable provisions of the Delaware General Corporation Law, as amended, for more information.

Description of Common Stock**Authorized Shares**

Our authorized capital stock consists of 35,000,000 shares of common stock, of which 14,946,839 shares were outstanding on February 27, 2020, held by 873 holders of record, and 1,000,000 shares of blank check preferred stock, of which no shares were outstanding on February 27, 2020.

Listing

Our common stock is traded on the OTC Market Group's OTCQB under the symbol "STLY."

Voting Rights

Subject to the rights of any holders of our preferred stock (of which there currently are none), each outstanding share of common stock entitles its holder to one vote on all matters submitted to a vote of our stockholders, including the election of directors. There are no cumulative voting rights. Generally, all matters to be voted on by stockholders must be approved by a majority of the votes entitled to be cast by all shares of common stock present or represented by proxy.

Dividends; Liquidation Rights and Other Rights

Subject to the rights of any holders of our preferred stock (of which there currently are none), holders of common stock are entitled to receive ratably such dividends as may be declared by the board of directors out of funds legally available therefore. In the event of liquidation, dissolution or winding up of our Company holders of common stock are entitled to share ratably in all assets remaining after payment of liabilities and satisfaction of any preferential rights of the holders of the preferred stock. Holders of common stock have no preemptive, subscription or conversion rights. There are no redemption or sinking fund provisions, and there is no liability for further calls or assessments by the Company.

Transfer Agent and Registrar

The transfer agent and registrar for our common stock is Continental Stock Transfer & Trust Company.

Preferred Stock

Pursuant to our certificate of incorporation, we are authorized to issue "blank check" preferred stock, which may be issued from time to time in one or more series upon authorization by our Board of Directors. Our Board of Directors, without further approval of the stockholders, is authorized to fix the dividend rights and terms, conversion rights, voting rights, redemption rights and terms, liquidation preferences, and any other rights, preferences, privileges and restrictions applicable to each series of the preferred stock. The issuance of preferred stock, while providing flexibility in connection with possible acquisitions and other corporate purposes could, among other things, adversely affect the voting power of the holders of common stock and, under certain circumstances, make it more difficult for a third party to gain control of us, discourage bids for our common stock at a premium or otherwise adversely affect the market price of our common stock.

Anti-Takeover Provisions

We are subject to Section 203 of the Delaware General Corporation Law. Subject to certain exceptions, Section 203 prevents a publicly held Delaware corporation from engaging in a “business combination” with any “interested stockholder” for three years following the date that the person became an interested stockholder, unless the interested stockholder attained such status with the approval of our board of directors or unless the business combination is approved in a prescribed manner. A “business combination” includes, among other things, a merger or consolidation involving us, and the interested stockholder and the sale of more than 10% of our assets. In general, an “interested stockholder” is any entity or person beneficially owning 15% or more of our outstanding voting stock and any entity or person affiliated with or controlling or controlled by such entity or person.

In addition, our certificate of incorporation and bylaws include a number of provisions that may have the effect of discouraging persons from pursuing non-negotiated takeover attempts. These provisions include:

- a classified board;
- a requirement that directors may only be removed for cause and only by an affirmative vote of the holders of a majority of the Company’s voting stock;
- the board’s authority to designate the rights and preferences of, and issue one or more series of, blank check preferred stock without stockholder approval; and
- the elimination of the ability of stockholders to call special meetings.

Options

As of February 27, 2020, options to purchase 42,283 shares of our common stock at a weighted average exercise price of \$6.20 per share were outstanding.

Description of Preferred Stock Purchase Rights

Stockholder Rights Plan

On December 5, 2016, we entered into a Rights Agreement (the “Agreement”) in an effort to protect against a possible limitation on our ability to use our net operating loss carryforwards (“NOLs”). We may utilize these NOLs in certain circumstances to offset future U.S. taxable income and reduce our U.S. federal income tax liability, which may arise even if we incur an accounting loss in a given period for reporting purposes. Our ability to utilize our NOLs, however, could be substantially limited if an “ownership change,” as defined under Section 382 of the Internal Revenue Code (the “Code”), occurred. In general, an ownership change would occur if and when the percentage of ownership of our one or more “5-percent shareholders” (as defined under IRC Section 382) has increased by more than 50 percentage points over their lowest ownership percentage at any time during the prior three years (calculated on a rolling basis). These provisions can be triggered not only by merger and acquisition activity but by trading as well. The Agreement is designed to deter trading that would result in an ownership change that could lead to the loss of the NOLs and a resulting reduction in our company’s value.

In connection with the adopting of the Agreement, our board of directors authorized and declared a dividend of one preferred stock purchase right (a “Right”) for each outstanding share of common stock to stockholders of record as of the close of business on December 15, 2016. In general, the Rights will work to impose a significant penalty upon any person or group which becomes the beneficial owner of 4.9% or more of our outstanding common stock or upon any 4.9% or greater holder which becomes the beneficial owner of an additional 1% or more of the outstanding shares of our common stock. There is no guarantee, however, that the Agreement will prevent us from experiencing an ownership change and, therefore, having a limitation on its ability to utilize its NOLs.

The Rights. Until the Separation Time (as defined below), each Right will be evidenced by either the registration of the associated share of our common stock on the stock transfer books or the certificate for the associated share of our common stock and may only be transferred with the associated share of our common stock. Following the Separation Time, separate certificates evidencing the Rights will be delivered to holders of record of our common stock as of the Separation Time and the Rights may be transferred independent of our common stock.

Holders' Rights as Stockholders. The holders of Rights will, solely by reason of their ownership of Rights, have no rights as our stockholders, including, without limitation, the right to vote or to receive dividends.

Exercisability of the Rights. The Rights are not exercisable until the close of business on the earlier of (i) the tenth business day (subject to adjustment by our board) after the date on which any person commences a tender or exchange offer that, if consummated, would result in such person becoming an Acquiring Person (as defined in the Rights Agreement) (provided that if any tender or exchange offer is cancelled, terminated or otherwise withdrawn prior to the close of business on the tenth business day following its commencement without the purchase of any shares of our common stock, such offer shall be deemed, for these purposes, to never have been made) and (ii) the next business day after the first date of public announcement by us or by an Acquiring Person that a person has become an Acquiring Person (such date being the "Stock Acquisition Announcement Date" and the close of business on the earlier of (i) or (ii) being the "Separation Time"). On or after the Separation Time and prior to the Expiration Time (as defined below), the Rights will be exercisable and each Right will entitle the holder thereof to purchase from us for \$8.00 (the "Exercise Price") one one-thousandth of a share of our Series A Participating Preferred Stock, par value \$0.01 per share (the "Preferred Stock").

Flip-In Event. In the event that a person becomes an Acquiring Person, each Right, other than those beneficially owned by the Acquiring Person which shall become null and void, will as of such date (the "Flip-in Date") constitute the right to purchase from us for the Exercise Price shares of our common stock having an aggregate Market Price (as defined in the Rights Agreement) equal to twice the Exercise Price.

Terms of the Preferred Stock. The terms of the Preferred Stock issuable upon exercise of the Rights are designed so that each one one-thousandth of a share of Preferred Stock is the economic and voting equivalent of one whole share of our common stock. In addition, the Preferred Stock has certain minimum dividend and liquidation rights, which are set out in the form of Certificate of Designation of Series A Participating Preferred Stock attached as Exhibit B to the Agreement.

Exchange. Our board may, at its option, at any time after a Flip-in Date and prior to the time that an Acquiring Person becomes the beneficial owner of more than 50% of the outstanding shares of our common stock, elect to exchange all (but not less than all) of the then outstanding Rights (other than Rights beneficially owned by the Acquiring Person or any affiliate thereof, which Rights shall become void) for shares of our common stock at an exchange ratio of one share of our common stock per Right, appropriately adjusted to reflect any stock split, stock dividend or similar transaction occurring after the Separation Time (the "Exchange Ratio"). Immediately upon such action by our board (the "Exchange Time"), the right to exercise the Rights will terminate and each Right will thereafter represent only the right to receive a number of shares of our common stock equal to the Exchange Ratio.

Substitution. Whenever we become obligated, as described in the preceding paragraphs, to issue shares of our common stock upon exercise of or in exchange for Rights, we, at our option, may substitute therefor shares of Preferred Stock, at a ratio of one one-thousandth of a share of Preferred Stock for each share of our common stock so issuable, or, subject to certain conditions, other debt or equity securities.

Exempt Persons. Any person desiring to engage in an acquisition of our common stock that, if consummated, might cause such person to become an Acquiring Person may request that our board exempt such acquisition from the provisions of the Agreement such that the person would not be deemed to be an Acquiring Person. Our board may grant any such request if it determines, in its sole discretion, that the acquisition (i) does not (x) create a significant risk of material adverse tax consequences to us or (y) constitute an event of default under our prior credit facility which is no longer in force or (ii) is otherwise in the best interests of the Company. Our board has granted several exemptions under the Agreement. Currently, the effective exemptions are (i) an exemption requested by Solas Capital Management, LLC (“Solas”) to purchase up to an additional 16.9% of our outstanding common stock (which would result in Solas owning approximately 34% of our outstanding stock if the remaining exempted amount of approximately 11.2% of our outstanding common stock was fully purchased), and (ii) an exemption requested by the Hale Funds permitting them to purchase up to an additional 14.4% of our outstanding common stock (which would result in the Hale Funds owning approximately 32% of our outstanding common stock if the remaining exempted amount of approximately 7.3% of our outstanding common stock was fully purchased).

Redemption. Our board may, at its option and at any time prior to a Flip-in Date, redeem all (but not less than all) of the then outstanding rights at a price of \$0.0001 per Right (the “Redemption Price”). Immediately upon the action of our board electing to redeem the Rights, and without any further action or notice, the right to exercise the Rights will terminate and each Right will thereafter represent only the right to receive the Redemption Price in cash or securities for each Right so held.

Anti-Dilution Adjustments. The Exercise Price and the number of Rights outstanding, or in certain circumstances the securities purchasable upon exercise of the Rights, are subject to adjustment from time to time to prevent dilution in the event of a stock dividend on, or a subdivision or a combination into a smaller number of shares of, our common stock, or the issuance or distribution of any securities or assets in respect of, in lieu of or in exchange for our common stock.

Supplements and Amendments. The Agreement may be supplemented or amended without the approval of holders of the Rights at any time and in any respect prior to the Flip-in Date. Subsequent to the Flip-in Date, the Agreement may only be supplemented or amended in certain limited circumstances as specified in the Agreement.

Expiration. The Rights and the Agreement will expire on the earliest of (i) the Exchange Time, (ii) the date on which the Rights are redeemed as described above, (iii) the close of business on the day after the 2020 Annual Meeting of Stockholders if the amendment to the Agreement set forth in Amendment No. 2 thereto is not approved by stockholders at the 2020 Annual Meeting of Stockholders, (iv) the close of business on December 5, 2022, and (v) the time at which our board determines, in its sole discretion, that the NOLs are utilized in all material respects or no longer available in any material respect under Section 382 of the Code or any applicable state law or that an ownership change under Section 382 of the Code would not adversely impact in any material respect the time period in which we could use the NOLs, or materially impair the amount of the NOLs that could be used by us in any particular time period, for applicable tax purposes (in any such case, the “Expiration Time”).

Subsidiaries

The following is a list of subsidiaries of HG Holdings, Inc.:

NONE

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

HG Holdings, Inc.
Charlotte, North Carolina

We hereby consent to the incorporation by reference in the Registration Statements of HG Holdings, Inc. on Form S-8 (Nos. 333-45402, 333-150369, and 333-182777) of our report dated March 13, 2020 relating to the consolidated financial statements as of December 31, 2019 and for the year ended December 31, 2019, which appears in the Company's annual report on Form 10-K.

/s/Cherry Bekaert, LLP
Richmond, Virginia
March 13, 2020

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

HG Holdings, Inc.
Charlotte, North Carolina

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos.333-45402, 333-150369, and 333-182777) of HG Holdings, Inc. of our report dated March 29, 2019 relating to the consolidated financial statements and financial statement schedule, which appear in this Form 10-K.

/s/BDO USA, LLP
Raleigh, North Carolina

March 13, 2020

I, Steven A. Hale II, certify that:

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

Date: March 13, 2020

/s/ Steven A. Hale II
Steven A. Hale II
Chairman and Chief Executive Officer

I, Brad G. Garner, certify that:

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

Date: March 13, 2020

/s/ Brad G. Garner
Brad G. Garner
Principal Financial and Accounting Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the HG Holdings, Inc. (the "Company") Annual Report on Form 10-K for the period ended December 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Steven A. Hale II, Chief Executive Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

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

Date: March 13, 2020

/s/ Steven A. Hale II
Steven A. Hale II
Chairman and Chief Executive Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the HG Holdings, Inc. (the "Company") Annual Report on Form 10-K for the period ended December 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Brad G. Garner, Principal Financial and Accounting Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

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

Date: March 13, 2020

/s/ Brad G. Garner
Brad G. Garner
Principal Financial and Accounting Officer

Information on HC Realty Common Stock, HC Realty Series B Stock and Loan Agreement with HC Realty

Certain information concerning the Common Stock and 10.00% Series B Cumulative Preferred Stock (the "Series B Preferred Stock") of HC Government Realty Trust, Inc. and the Loan Agreement, dated as of March 19, 2019, by and between HC Government Realty Holdings, L.P., as borrower, the Lenders party thereto (which lenders include HG Holdings, Inc.) and HCM Agency, LLC, as collateral agent (the "Loan Agreement") is provided below.

Common Stock*Dividends*

Dividends on HC Realty common stock are subject to HC Realty's ability to generate positive cash flow from operations. All dividends are further subject to the discretion of the board of directors of HC Realty. It is possible that HC Realty may have cash available for dividends, but its board of directors could determine that the reservation, and not distribution, of such to be in its best interest. Holders of HC Realty 7.00% Series A Cumulative Convertible Preferred Stock (the "Series A Preferred Stock") are entitled to preferred returns before dividends are issued to holders of our common stock. At October 7, 2019, HC Realty had provided holders of its common stock with an annualized dividend of 5.5%, or \$0.55 per share.

Liquidation Preference

No liquidation preference is provided for holders of HC Realty common stock. Upon the dissolution and liquidation of HC Realty, Series A Preferred Stock will receive a preference in the distribution of liquidation proceeds equal to any accrued and unpaid preferred returns. Following payment of any accrued but unpaid preferred returns to Series A Preferred Stock, liquidating distributions will be shared *pari passu* between our common stock and Series A Preferred Stock, subject to the right of our board of directors to designate the rights and privileges of HC Realty's authorized but unissued preferred stock in the future.

Registrar, Transfer Agent and Paying Agent

Shares of HC Realty common stock will be held in "uncertificated" form, which will eliminate the physical handling and safekeeping responsibilities inherent in owning transferable stock certificates and eliminate the need to return a duly executed stock certificate to effect a transfer. Direct Transfer LLC 1 acts as HC Realty's registrar and as the transfer agent for our shares.

Stockholder Voting

Subject to the restrictions on ownership and transfer of stock contained in HC Realty's charter and except as may otherwise be specified in HC Realty's charter, each share of common stock will have one vote per share on all matters voted on by stockholders, including election of directors. Holders of common stock will vote with holders of the Series A Preferred Stock on all matters to which holders of HC Realty common stock are entitled to vote.

Generally, the affirmative vote of a majority of all votes cast is necessary to take stockholder action, except that a plurality of all the votes cast at a meeting at which a quorum is present is sufficient to elect a director and except as set forth in the next paragraph.

Under Maryland law, a Maryland corporation generally cannot dissolve, amend its charter, merge, sell all or substantially all of its assets, engage in a share exchange or engage in similar transactions outside the ordinary course of business, unless approved by the affirmative vote of stockholders holding at least two-thirds of the shares entitled to vote on the matter. However, a Maryland corporation may provide in its charter for approval of these matters by a lesser percentage, but not less than a majority of all of the votes entitled to be cast on the matter. HC Realty's charter provides for a majority vote in these situations. HC Realty's charter further provides that any or all of its directors may be removed from office for cause, and then only by the affirmative vote of at least a majority of the votes entitled to be cast generally in the election of directors. For these purposes, "cause" means, with respect to any particular director, conviction of a felony or final judgment of a court of competent jurisdiction holding that such director caused demonstrable material harm to us through bad faith or active and deliberate dishonesty.

Each stockholder entitled to vote on a matter may do so at a meeting in person or by proxy directing the manner in which he or she desires that his or her vote be cast or without a meeting by a consent in writing or by electronic transmission. Any proxy must be received by HC Realty prior to the date on which the vote is taken. Pursuant to Maryland law and our bylaws, if no meeting is held, 100% of the stockholders must consent in writing or by electronic transmission to take effective action on behalf of HC Realty, unless the action is advised, and submitted to the stockholders for approval, by its board of directors, in which case such action may be approved by the consent in writing or by electronic transmission of stockholders entitled to cast not less than the minimum number of votes that would be necessary to authorize or take the action at a meeting of stockholders.

Series B Preferred Stock

In connection with the recapitalization transaction (the "Recapitalization") with Hale Partnership Capital Management, LLC ("Hale") and certain affiliated investors (each, an "Investor" and collectively, the "Investors"), on March 14, 2019, HC Realty filed Articles Supplementary with the Maryland State Department of Assessments and Taxation (the "Series B Articles Supplementary") to classify 2,050,000 shares of its preferred stock, a portion of which are as shares of Class B Preferred Stock to be purchased by Hale pursuant to the Recapitalization. The Series B Articles Supplementary became effective upon filing on March 14, 2019.

Holders of shares of the Series B Preferred Stock are entitled to receive cumulative cash dividends on the Series B Preferred Stock when, as and if authorized by the Board and declared by HC Realty, payable quarterly in arrears on each January 5th, April 5th, July 5th and October 5th of each year. From the date of original issue, HC Realty will pay dividends at the rate of 10.00% per annum of the \$10.00 liquidation preference per share. Dividends on the Series B Preferred Stock will accrue and be cumulative from the end of the most recent dividend period for which dividends have been paid. With respect to priority of payment of dividends, the Series B Preferred Stock will rank on a parity with the Series A Preferred Stock.

If HC Realty liquidates, dissolves or winds-up, holders of shares of the Series B Preferred Stock will have the right to receive \$10.00 per share of the Series B Preferred Stock, plus an amount equal to all accrued and unpaid dividends (whether or not authorized or declared) to and including the date of payment. With respect to priority of payment of distributions upon HC Realty's voluntary or involuntary liquidation, dissolution or winding up, the Series B Preferred Stock will rank on a parity with the Series A Preferred Stock.

The Series B Preferred Stock will automatically convert into common stock upon the occurrence of their initial listing of HC Realty common stock on any national securities exchange. As of the date of the listing event, a holder of shares of Series B Preferred Stock will receive a number of shares of common stock in accordance with the conversion formula set forth in the Series B Articles Supplementary. Pursuant to the conversion formula, one share of the Series B Preferred Stock will convert to a number of shares of common stock equal to the original issue price of the Series B Preferred Stock (plus any accrued and unpaid dividends) divided by the lesser of \$9.10 or the fair market value of the common stock. If the listing event has not occurred on or prior to March 31, 2020, then holders of the Series B Preferred Stock, at their option, may, at any time and from time to time after such date, convert all, but not less than all, of their outstanding shares of Series B Preferred Stock into common stock. Upon exercise of this optional conversion right, a holder of Series B Preferred Stock will receive a number of shares of common stock in accordance with the same conversion formula referenced above.

Subject to the preferential voting rights described below, the Series B Preferred Stock have identical voting rights as HC Realty common stock, with each share of Series B Preferred Stock entitling its holder to vote on an as converted basis, on all matters on which HC Realty common stockholders are entitled to vote. The Series B Preferred Stock, the Series A Preferred Stock and the common stock vote together as one class. So long as any shares of Series B Preferred Stock remain outstanding, in addition to the voting rights described above, HC Realty will not, without the affirmative vote or consent of the holders of at least two-thirds of the outstanding shares of Series B Preferred Stock voting together as a single class, authorize, create or issue, or increase the number of authorized or issued shares of, any class or series of capital stock ranking senior to the Series B Preferred Stock with respect to payment of dividends or the distribution of assets upon our liquidation, dissolution or winding up, or reclassify any of our authorized capital stock into such capital stock, or create, authorize or issue any obligation or security convertible into or evidencing the right to purchase such capital stock. In addition, so long as any shares of Series B Preferred Stock remain outstanding, a majority of the members of the board of directors of HC Realty is to be elected by the holders of a majority of the outstanding shares of Series B Preferred Stock.

In addition, the holders of the Series B Preferred Stock have registration rights that are substantially similar to those granted to the holders of the Series A Preferred Stock.

Loan Agreement

In connection with the closing of the Recapitalization, on March 19, 2019, HC Realty, through the OP, the Investors and HCM Agency, LLC (the "Agent"), an affiliate of Hale and the collateral agent, entered into a Loan Agreement (the "Loan Agreement") pursuant to which certain of the Investors, as lenders (the "Lenders") provided a \$10,500,000 senior secured term loan to HC Realty (the "Loan"), with an option to fund up to an additional \$10,000,000 in term loans, subject to customary terms and conditions, pursuant to which all such debt will accrue interest and mature on the same terms (the "Mezzanine Debt").

The Loan is not evidenced by a promissory note. However, pursuant to the Loan Agreement, promissory notes evidencing the Loan and/or the Mezzanine Debt may be issued in the future at the request of the Lenders.

The Mezzanine Debt will accrue interest at a rate of fourteen percent (14%) per annum. Such interest will be paid in monthly, interest-only cash payments payable in arrears at a rate of twelve percent (12%) per annum plus (i) a cash payment at a rate of two percent (2%) per annum, (ii) an increase in the principal of the Mezzanine Debt equal to two percent (2%) per annum or (iii) a combination of both (i) and (ii) above, which such combined amount will be equal to two percent (2%) per annum. HC Realty is required to repay all outstanding principal and any accrued but unpaid interest on or before March 19, 2022. All outstanding principal and any accrued but unpaid interest shall become immediately due and payable upon certain events including, but not limited to, an initial public offering of HC Realty's common stock.

The Mezzanine Debt is secured by a security interest in the accounts receivable and other personal property of the OP, HC Realty and its subsidiaries, including the OP's ownership interest in its subsidiaries. The Company and Holmwood Portfolio Holdings, LLC, a limited partner in HC Realty's operating partnership, HC Government Realty Trust, L.P., a Delaware limited partnership, also entered into customary guaranty agreements related to the payment by and performance of the OP of its obligations under the Loan Agreement.

The Loan Agreement also includes customary representations, warranties, covenants and terms and conditions for transactions of this type, including a minimum fixed charge coverage ratio, limitations on incurrence of debt, liens, investments and mergers and asset dispositions, covenants to preserve corporate existence and comply with laws, covenants on the use of proceeds of the Mezzanine Debt and default provisions, including defaults for non-payment, breach of representations and warranties, insolvency, non-performance of covenants, failure to pay other outstanding debt and HC Realty's failure to maintain its REIT status. The occurrence of an event of default under the Loan Agreement could result in all loans and other obligations becoming immediately due and payable and allow the Agent to exercise all rights and remedies available to it as collateral agent including the foreclosure of all liens granted under the Loan Agreement.