Created by
Jasper Deasey, COO
Manvir Grewal, CIO

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Alma Investment Group
Equity Research

HG Holdings (OTCMKTS: STLY)

(Formerly Stanley Furniture Company)

Recent News

On March 2, 2018, Stanley Furniture Company sold substantially all of its assets to Churchill Downs LLC, delisted from all major exchanges, changed its business plan, and assumed the name HG Holdings. After the sale of its assets, the company is pivoting from a furniture company to a holding company run by Steven Hale, an experienced investor. The company is cash rich and is currently trading for well below its intrinsic value. As a result, Alma Investment Group rates HG Holdings as a BUY, with large upside potential and relatively little risk.

Investment Thesis: HG Holdings is holding liquid assets worth more than its current market cap

After the sale of its assets, HG Holdings was left with no operations, but a significant amount of highly liquid assets – the vast majority of which of which is cash, but it also includes a large promissory note, tax refunds, and a large stake in Churchill Downs LLC, the company they sold the assets to. In total, we believe the company has a net present value of roughly $13,295,000 USD, which is significantly above the company's current market cap of $8,502,000 USD. On a per share basis, we believe it's current value is $0.89 USD while it is currently trading for $0.57 USD.

Even though the company is simple to value, the market is pricing it at a discount for a variety of reasons. The first and largest reason is that due to the stock's delisting, many investors have been forced to sell. In addition, many investors who would otherwise want to purchase can no longer buy the stock as it is only available via over the counter markets.

Recommendation

Overall, Alma Investment Group is confident that HG Holdings is a BUY. The risks of the investment are limited, and the upsides are plentiful. In a worst-case scenario, we would expect a small drop in share price to $0.56, while the intrinsic value of the stock is a significant rise in price to $0.89. As a result of our analysis, we have added the company to our portfolio.

Valuation

Rating	**BUY**
Price (May 11, 2018)	**$ 0.57 USD**
Target Price	**$ 0.89 USD**
Total Return	**56%**

** Target Price is for 12 months*

Company Financials

52-Week Price Range	**$ 1.39 - 0.52**
Market Cap	**$ 8,502,000**
Enterprise Value	**$ 1,027,690**
Shares Outstanding	**14,917,000**
Price-to-book ratio	**$ 0.7273**

Company Overview

Previous to the asset sale, HG Holdings was named Stanley Furniture Company and the company manufactured furniture products in North America for over 70 years. Stanley had a solid reputation as a seller of high quality furniture. Their main operations and assets were located in Vietnam, where they manufactured the furniture. It was a profitable business for many years, until the 2009 recession was exceptionally difficult on their sales. After 2009 the company failed to become profitable again. As a result, the company decided the best course of action was to sell substantially all of their assets and leave the furniture industry.

On March 2, 2018, Stanley finalized their agreement with Churchill Downs LLC to sell their assets for $10.3 million USD Cash, 5% of the parent company, Churchill Downs LLC, worth $168,000 USD, and a subordinate note worth $7.4 million USD with 6% interest, which matures on March 2, 2023. Stanley Furniture Company also changed their name to HG Holdings and is now a holding company run by Steven Hale.

Management Overview

After the asset sale, the company came under the management of Steven A. Hale, the new Chairman and CEO. Mr. Steven A. Hale, II, is a Manager at Hale Partnership Capital Management LLC, an investment firm that focuses on investments that are undervalued due to the regulatory and investment mandate restrictions under which they operate. Stanley Furniture Company was an investment made under this thesis. Previous to Hale Partnership Capital Management LLC, Mr. Hale was employed as an Associate Director by Babson Capital Management LLC.

Mr. Hale has impressive credentials and industry experience. We expect that his management will be strong guidance for HG Holdings.

Valuation

As HG Holdings has no foreseeable operations, a sum-of-parts valuation on its net assets and liabilities is an appropriate valuation method. Fortunately, the company is rather straight-forward to value as the majority of assets and liabilities are highly liquid. A summary of the company's finances is beside this text, and an in-depth explanation of important sections is provided on the following page.

HG Holdings Financial Summary	
Segment	$ (thousands)
Cash	6,843
Restricted Cash	632
Other Assets	31
Subordinated Note Receivable	4,800
5% Stake in Churchill Downs LLC	168
Duty Refunds	86
Income Tax Allowance	2,300
Current Liabilities	-729
Long-Term Liabilities	-836
Total	13,295
Shares Outstanding	14,917
Value Per Share	$ 0.89

FINANCIAL SUMMARY

ASSETS

Cash - $6,843,000

Cash is mainly comprised of the $10.3 million asset sale, minus $1.3 million used to pay outstanding debts and $2.15 million in costs necessary to prepare and negotiate the sale.

Restricted Cash - $632,000

Cash restricted mainly to paying workers compensation claims, which total roughly $900,000

Prepaid Expenses and Other Current Assets - $31,000

Subordinated Note Receivable - $4,800,000 (discounted to fair value)

As part of the asset sale, Churchill Downs LLC promised a note worth $7.4 million with 6% interest that matures on March 2, 2023. The present value of the note is calculated using a 18% discount rate, which is based on a variety of factors, including current mezzanine/subordinated debt like returns in the market and the risk profile of Churchill Downs LLC. The note is risky, considering the business sold to Churchill Downs LLC generated negative EBITDA in the last three quarters, so there is no guarantee that the loan will be repaid. This risk is reflected in the high discount rate.

5% Stake in Churchill Downs LLC - $168,000

HG Holdings owns 5% of Churchill Downs LLC as a result of the asset sale, which is determined to be a variable interest and therefore does not give HG Holdings the power to direct the activities that most significantly impact the economic performance of Churchill.

Duty Refunds - $86,000

The Continued Dumping and Subsidy Offset Act is a US law where duties charged on products by the US were distributed to firms affected by foreign competition. Stanley Furniture was a large recipient of funds, however in 2007 the law was repealed by the World Trade Organization. Stanley received $432,000 from duties collected prior to 2007 in the 2017 customs fiscal year, and the valuation allowance has $233,000 in funds that are still collectible. HG Holdings is entitled to ~37% of that, which is equal to $86,000. These duty refunds may or may not be material.

Income Tax Valuation Allowance - $2,300,000

Stanley Furniture accumulated $21.8 million in federal net operating losses, and with a tax rate of 21% this allows HG Holdings to offset up to $4.6 million in taxes. This money will not be realized immediately and is not guaranteed, so a discount rate is necessary. Due to the risk and the time, we conservatively assume it to be currently worth half of its total value.

LIABILITIES

Current Liabilities - $729,000

Mainly comprised of workers compensation, which is accounted for as restricted cash

Long-term Liabilities - $836,000

Catalysts

Acquisitions – Although the company is currently worth less than their assets, they have very little cash flows and thus no way to create more value for shareholders. The company's objective is to buy undervalued companies, and if this occurs it could cause the market to jolt the share price up to its intrinsic value.

Risks

Bankruptcy of Churchill Downs LLC – HG Holdings has much of its value invested in Churchill Downs LLC. If the company were to go bankrupt, the 5% ownership would be worthless, and the promissory note would be worth its liquidation value. Churchill has substantial debts but positive cash flows and has been able to pay off the debts thus far. This being said, the assets Churchill bought from Stanley did not generate positive cash flows before the sale, so it is possible they could be detrimental to Churchill.

In the unlikely event that Churchill Downs LLC's stock price falls zero and they are unable to repay the promissory note, it would take nearly $5 million of value from HG Holdings. Per share, this would be a $0.33 loss and the new intrinsic value would be $0.56.

It is worth noting that $0.56 is only barely below the stocks current valuation, and the event that Churchill Downs LLC is worth nothing is an unlikely situation.

Disclaimer

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