GWG Holdings, Inc.
Form 10-Q
May 11, 2018
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2018

or

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

For the transition period from _________ to ________

Commission File Number: None

GWG HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware		26-2222607
(State or other jurisdiction of incorporation or organization)		(I.R.S. Employer Identification No.)

220 South Sixth Street, Suite 1200

Minneapolis, MN 55402

(Address of principal executive offices, including zip code)

(612) 746-1944

(Registrant's telephone number, including area code)

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. x Yes ¨ No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an 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.

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	x
		Emerging growth company	x

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 x No

As of May 11, 2018, GWG Holdings, Inc. had 5,813,555 shares of common stock outstanding.

GWG HOLDINGS, INC.

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for the Quarter Ended March 31, 2018

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GWG HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2018 (unaudited)	December 31, 2017
ASSETS		
Cash and cash equivalents	$ 141,212,907	$ 114,421,491
Restricted cash	16,552,256	28,349,685
Investment in life insurance policies, at fair value	687,389,479	650,527,353
Secured MCA advances	1,639,818	1,661,774
Life insurance policy benefits receivable	12,302,730	16,658,761
Other assets	7,402,317	7,237,110
TOTAL ASSETS	$ 866,499,507	$ 818,856,174
LIABILITIES & STOCKHOLDERS' EQUITY		
LIABILITIES		
Senior credit facility with LNV Corporation	$ 209,447,613	$ 212,238,192
L Bonds	469,729,977	447,393,568
Accounts payable	3,611,900	6,394,439
Interest and dividends payable	15,896,267	15,427,509
Other accrued expenses	4,066,763	3,730,723
TOTAL LIABILITIES	$ 702,752,520	$ 685,184,431
STOCKHOLDERS' EQUITY		
REDEEMABLE PREFERRED STOCK (par value $0.001; shares authorized 100,000; shares outstanding 98,358 and 98,611; liquidation preference of $98,932,000 and $99,186,000 as of March 31, 2018 and December 31, 2017, respectively)	90,915,026	92,840,243
SERIES 2 REDEEMABLE PREFERRED STOCK (par value $0.001; shares authorized 150,000; shares outstanding 134,951 and 88,709; liquidation preference of $135,712,000 and $89,208,000 as of March 31, 2018 and December 31, 2017, respectively)	121,454,205	80,275,204
COMMON STOCK (par value $0.001: shares authorized 210,000,000; shares issued and outstanding 5,813,555 as of both March 31, 2018 and December 31, 2017)	5,813	5,813
Additional paid-in capital	—	—
Accumulated deficit	(48,628,057)	(39,449,517)
TOTAL STOCKHOLDERS' EQUITY	163,746,987	133,671,743
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$ 866,499,507	$ 818,856,174

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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GWG HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended March 31, 2018	March 31, 2017
REVENUE		
Gain on life insurance policies, net	$ 13,868,745	$ 19,399,819
MCA income	66,810	246,577
Interest and other income	606,117	441,949
TOTAL REVENUE	14,541,672	20,088,345
EXPENSES		
Interest expense	16,063,337	13,244,215
Employee compensation and benefits	3,742,669	3,163,062
Legal and professional fees	1,173,629	946,348
Other expenses	2,740,577	2,780,322
TOTAL EXPENSES	23,720,212	20,133,947
INCOME (LOSS) BEFORE INCOME TAXES	(9,178,540)	(45,602)
INCOME TAX EXPENSE (BENEFIT)	—	(500)
NET INCOME (LOSS)	(9,178,540)	(45,102)
Preferred stock dividends	3,704,484	1,867,760
NET INCOME (LOSS) ATTRIBUTABLE TO COMMON SHAREHOLDERS	$ (12,883,024)	$ (1,912,862)
NET INCOME (LOSS) PER SHARE		
Basic	$ (2.22)	$ (0.32)
Diluted	$ (2.22)	$ (0.32)
WEIGHTED AVERAGE SHARES OUTSTANDING		
Basic	5,813,555	5,912,946
Diluted	5,813,555	5,912,946

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

GWG HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Three Months Ended March 31, 2018	March 31, 2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ (9,178,540)	$ (45,102)
Adjustments to reconcile net income (loss) to net cash flows from operating activities:		
Change in fair value of life insurance policies	(16,645,594)	(13,883,833)
Amortization of deferred financing and issuance costs	2,263,188	2,666,203
Deferred income taxes	—	(500)
Preferred stock issued in lieu of cash dividends	—	336,789
(Increase) decrease in operating assets:		
Life insurance policy benefits receivable	4,356,031	(3,630,000)
Other assets	(165,207)	1,426,318
Increase (decrease) in operating liabilities:		
Accounts payable and other accrued expenses	(1,545,208)	1,209,417
NET CASH FLOWS USED IN OPERATING ACTIVITIES	(20,915,330)	(11,920,708)
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment in life insurance policies	(25,299,825)	(22,689,333)
Carrying value of matured life insurance policies	5,083,294	2,368,974
Proceeds from Secured MCA advances	88,766	770,387
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(20,127,765)	(19,549,972)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net borrowings on (repayments of) Senior Credit Facilities	(3,054,335)	(3,254,500)
Payments for issuance of senior debt	—	(114,294)
Payments for redemption of Series I Secured Notes	—	(5,449,889)
Proceeds from issuance of L Bonds	36,661,099	24,868,659
Payments for issuance and redemption of L Bonds	(12,245,448)	(24,171,597)
Repurchase of common stock	—	(1,603,560)
Proceeds from issuance of preferred stock	41,865,169	27,179,194
Payment for issuance of preferred stock	(3,157,695)	(2,017,487)
Payment for redemption of preferred stock	(327,224)	(386,739)
Preferred stock dividends	(3,704,484)	(1,867,760)
NET CASH FLOWS PROVIDED BY FINANCING ACTIVITIES	56,037,082	13,182,027
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	14,993,987	(18,288,653)
CASH AND CASH EQUIVALENTS AND RESTRICTED CASH		
BEGINNING OF PERIOD	142,771,176	116,313,578
END OF PERIOD	$ 157,765,163	$ 98,024,925

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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GWG HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS — CONTINUED

(unaudited)

	Three Months Ended March 31, 2018		March 31, 2017	
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION				
Interest paid	$	13,475,000	$	10,471,000
Premiums paid, including prepaid	$	11,833,000	$	10,960,000
Stock-based compensation	$	213,000	$	303,000
Payments for exercised stock options	$	37,000	$	—
NON-CASH INVESTING AND FINANCING ACTIVITIES				
L Bonds:				
Conversion of accrued interest and commissions payable to principal	$	342,000	$	508,000
Conversion of maturing L Bonds to redeemable preferred stock	$	4,421,000	$	—
Series A Preferred Stock:				
Issuance of Series A Preferred Stock in lieu of cash dividends	$	—	$	171,000
Investment in life insurance policies included in accounts payable	$	1,350,000	$	1,237,000

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

GWG HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(unaudited)

	Preferred Stock Shares	Preferred Stock	Common Shares	Common Stock (par)	Additional Paid-in Capital	Accumulated Deficit	Total Equity
Balance, December 31, 2016	**2,699,704**	**$ 78,726,297**	**5,980,190**	**$ 5,980**	**$ 7,383,515**	**$ (18,817,294)**	**$ 67,298,498**
Net loss	—	—	—	—	—	(20,632,223)	(20,632,223)
Issuance of common stock	—	—	33,810	33	320,970	—	321,003
Redemption of common stock	—	—	(200,445)	(200)	(1,603,360)	—	(1,603,560)
Issuance of Series A preferred stock	71,237	498,659	—	—	—	—	498,659
Redemption of Series A preferred stock	(2,711,916)	(20,199,792)	—	—	—	—	(20,199,792)
Issuance of redeemable preferred stock	129,622	122,933,106	—	—	(2,338,457)	—	120,594,649
Redemption of redeemable preferred stock	(1,328)	(1,327,776)	—	—	—	—	(1,327,776)
Preferred stock dividends	—	(8,925,807)	—	—	(3,776,534)	—	(12,702,341)
Stock-based compensation	—	1,410,760	—	—	13,866	—	1,424,626
Balance, December 31, 2017	**187,319**	**$ 173,115,447**	**5,813,555**	**$ 5,813**	**$ —**	**$ (39,449,517)**	**$ 133,671,743**
Net income	—	—	—	—	—	(9,178,540)	(9,178,540)
Issuance of redeemable	46,317	43,159,571	—	—	—	—	43,159,571

preferred stock							
Redemption of redeemable preferred stock	(327)	(327,224)	—	—	—	—	(327,224)
Preferred stock dividends	—	(3,704,484)	—	—	—	—	(3,704,484)
Stock-based compensation	—	125,921	—	—	—	—	125,921
Balance, March 31, 2018	**233,309**	**$ 212,369,231**	**5,813,555**	**$ 5,813**	**$ —**	**$ (48,628,057)**	**$ 163,746,987**

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(1) Nature of Business and Summary of Significant Accounting Policies

Nature of Business — We are a financial services company committed to disrupting and transforming the life insurance and related industries. We built our business by creating opportunities for consumers to obtain significantly more value for their life insurance policies in a secondary market as compared to the traditional options offered by the insurance industry. We are enhancing and extending our activities in the life insurance industry through innovation in our products and services, business processes, financing strategies, and advanced epigenetic technologies. At the same time, we are creating opportunities for investors to receive income and capital appreciation from our investment activities in the life insurance and related industries.

GWG Holdings, Inc. and all of its subsidiaries are incorporated and organized in Delaware. Unless the context otherwise requires or we specifically so indicate, all references in these footnotes to “we,” “us,” “our,” “our Company,” “GWG or the “Company” refer to GWG Holdings, Inc. and its subsidiaries collectively and on a consolidated basis. References to the full names of particular entities, such as “GWG Holdings, Inc.” or “GWG Holdings,” are meant to refer only to the particular entity referenced.

On December 7, 2015, GWG Holdings formed a wholly owned subsidiary, GWG MCA, LLC. On January 13, 2016, GWG MCA, LLC was converted to a corporation and became GWG MCA Capital, Inc. GWG MCA Capital, Inc. was formed to provide cash advances to small businesses.

On August 25, 2016, GWG Holdings formed a wholly owned subsidiary, Actüa Life & Annuity Ltd., renamed to Life Epigenetics Inc. (“Life Epigenetics”) in August 2017, to engage in various life insurance related businesses and activities related to its exclusive license for “DNA Methylation Based Predictor of Mortality” technology.

Use of Estimates — The preparation of our condensed consolidated financial statements in conformity with the Generally Accepted Accounting Principles in the United States of America (GAAP) requires management to make significant estimates and assumptions affecting the reported amounts of assets and liabilities at the date of the condensed consolidated financial statements, as well as the reported amounts of revenue during the reporting period. We regularly evaluate estimates and assumptions, which are based on current facts, historical experience, management’s judgment, and various other factors that we believe to be reasonable under the circumstances. Our actual results may differ materially and adversely from our estimates. The most significant estimates with regard to these condensed consolidated financial statements relate to (1) the determination of the assumptions used in estimating the fair value of our investments in life insurance policies and (2) the value of our deferred tax assets and liabilities.

Cash and Cash Equivalents — We consider cash in demand deposit accounts and temporary investments purchased with an original maturity of three months or less to be cash equivalents. We maintain our cash and cash equivalents with highly rated financial institutions. The balances in our bank accounts may exceed Federal Deposit Insurance Corporation limits. We periodically evaluate the risk of exceeding insured levels and may transfer funds as we deem appropriate.

Life Insurance Policies — Accounting Standards Codification 325-30, Investments in Insurance Contracts permits a reporting entity to account for its investments in life insurance policies using either the investment method or the fair value method. We elected to use the fair value method to account for our life insurance policies. We initially record our purchase of life insurance policies at the transaction price, which is the amount paid for the policy, inclusive of all external fees and costs associated with the acquisition. At each subsequent reporting period, we re-measure the investment at fair value in its entirety and recognize the change in fair value as unrealized gain or loss in the current period, net of premiums paid, within gain on life insurance policies, net in our condensed consolidated statements of operations.

In a case where our acquisition of a policy is not complete as of a reporting date, but we have nonetheless advanced direct costs and deposits for the acquisition, those costs and deposits are recorded as other assets on our condensed consolidated balance sheets until the acquisition is complete and we have secured title to the policy. On both March 31, 2018 and December 31, 2017, a total of $0 of our other assets comprised direct costs and deposits that we had advanced for life insurance policy acquisitions.

(1) Nature of Business and Summary of Significant Accounting Policies (cont.)

We also recognize realized gain (or loss) from a life insurance policy upon one of the two following events: (1) our receipt of notice or verified mortality of the insured; or (2) our sale of the policy (upon filing of change-of-ownership forms and receipt of payment). In the case of mortality, the gain (or loss) we recognize is the difference between the policy benefits and the carrying value of the policy once we determine that collection of the policy benefits is realizable and reasonably assured. In the case of a policy sale, the gain (or loss) we recognize is the difference between the sale price and the carrying value of the policy on the date we receive sale proceeds.

Other Assets — Life Epigenetics is engaged in various life insurance related businesses and activities related to its exclusive license for the "DNA Methylation Based Predictor of Mortality" technology for the life insurance industry. The cost of entering into this license agreement is included in other assets on our condensed consolidated balance sheets.

To maintain the Company's life insurance provider licenses in certain states, we are required to keep cash security deposits with the states' licensing authorities. Security deposits included in other assets were $575,000 at both March 31, 2018 and December 31, 2017.

Stock-Based Compensation — We measure and recognize compensation expense for all stock-based payments at fair value on the grant date over the requisite service period. We use the Black-Scholes option pricing model to determine the weighted-average fair value of options. For restricted stock grants, fair value is determined as of the closing price of our common stock on the date of grant. Stock-based compensation expense is recorded in general and administrative expenses based on the classification of the employee or vendor. The determination of fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as by assumptions regarding a number of subjective variables. These variables include, but are not limited to, the expected stock price volatility over the term of the awards and the expected duration.

The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected life at grant date. Volatility is based on the standard deviation of the average continuously compounded rate of return of five selected comparable companies. We have not historically issued any common stock dividends and do not expect to do so in the foreseeable future.

Deferred Financing and Issuance Costs — Loans advanced to us under our senior credit facility with LNV Corporation, as described in Note 6, are reported net of financing costs, including issuance costs, sales commissions and other direct expenses, which are amortized using the straight-line method over the term of the facility. We had no loans advanced to us under our senior credit facility with Autobahn Funding Company during the year ended December 31, 2017, as described in Note 5. The Series I Secured Notes and L Bonds, as respectively described in Notes 7 and 8, are reported net of financing costs, which are amortized using the interest method over the term of those borrowings. The Series A Convertible Preferred Stock ("Series A"), as described in Note 9, was reported net of financing costs (including the fair value of warrants issued), all of which were fully amortized using the interest method as of December 31, 2017. Selling and issuance costs of Redeemable Preferred Stock ("RPS") and Series 2 Redeemable Preferred Stock ("RPS 2"), described in Notes 10 and 11, are netted against additional paid-in-capital, if any, and then against the outstanding balance of the preferred stock.

Earnings (loss) per Share — Basic earnings (loss) per share attributable to common shareholders are calculated using the weighted-average number of shares outstanding during the reported period. Diluted earnings (loss) per share are calculated based on the potential dilutive impact of our Series A, RPS, RPS 2, warrants and stock options. Due to our net loss attributable to common shareholders for the three months ended March 31, 2018, there are no dilutive securities.

Recently Issued Accounting Pronouncements — On February 25, 2016, the FASB issued Accounting Standards Update 2016-02 Leases ("ASU 2016-02"). The new guidance is effective for fiscal years beginning after December 15, 2018. ASU 2016-02 provides more transparency and comparability in the financial statements of lessees by recognizing all leases with a term greater than twelve months on the balance sheet. Lessees will also be required to disclose key information about their leases. Early adoption is permitted. We are currently evaluating the impact of the adoption of this pronouncement and have not yet adopted ASU 2016-02 as of March 31, 2018.

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(1) Nature of Business and Summary of Significant Accounting Policies (cont.)

In March 2016, the FASB issued Accounting Standards Update 2016-09 ("ASU 2016-09") to simplify the accounting for stock compensation related to the following items: income tax accounting, award classification, estimation of forfeitures, and cash flow presentation. The new guidance is effective for fiscal years beginning after December 15, 2016. We adopted ASU 2016-09 effective January 1, 2017. The impact of the adoption was not material to the financial statements.

In November 2016, the FASB issued Accounting Standards Update 2016-18 ("ASU 2016-18"), which amends ASC 230 Statement of Cash Flows to add or clarify guidance on the classification and presentation of restricted cash in the statement of cash flows. The guidance, to be applied retrospectively when adopted, requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. The new guidance is effective for fiscal years beginning after December 15, 2017, and interim periods within those years. We adopted ASU 2016-18 as of March 31, 2018. The impact of the adoption was not material to the financial statements.

(2) Restrictions on Cash

Under the terms of our senior credit facility with LNV Corporation (discussed in Note 6), we are required to maintain collection and payment accounts that are used to collect policy benefits from pledged policies, pay annual policy premiums, interest and other charges under the facility, and distribute funds to pay down the facility. The agents for the lender authorize the disbursements from these accounts. At March 31, 2018 and December 31, 2017, there was a balance of $11,735,000 and $19,967,000, respectively, in these collection and payment accounts.

To fund the Company's acquisition of life insurance policies, we are required to maintain escrow accounts. Distributions from these accounts are made according to life insurance policy purchase contracts. At March 31, 2018 and December 31, 2017, there was a balance of $4,818,000 and $8,383,000, respectively, in the Company's escrow accounts.

(3) Investment in Life Insurance Policies

Life insurance policies are valued based on unobservable inputs that are significant to their overall fair value. Changes in the fair value of these policies, net of premiums paid, are recorded in gain on life insurance policies, net in our condensed consolidated statements of operations. Fair value is determined on a discounted cash flow basis that incorporates life expectancy assumptions generally derived from reports obtained from widely accepted life expectancy providers, other than insured lives covered under small face amount policies (i.e., $1 million in face value benefits or less), assumptions relating to cost-of-insurance (premium) rates and other assumptions. The discount rate we apply incorporates current information about discount rates applied by other public reporting companies owning portfolios of life insurance policies, the discount rates observed in the life insurance secondary market, market interest rates, the estimated credit exposure to the insurance companies that issued the life insurance policies and management's estimate of the operational risk premium a purchaser would require to receive the future cash flows derived from our portfolio as a whole. Management has discretion regarding the combination of these and other factors when determining the discount rate. As a result of management's analysis, a discount rate of 10.45% was applied to our portfolio as of both March 31, 2018 and December 31, 2017.

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GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(3) Investment in Life Insurance Policies (cont.)

A summary of our policies, organized according to their estimated life expectancy dates as of the reporting date, is as follows:

	As of March 31, 2018			As of December 31, 2017		
Years Ending December 31,	Number of Policies	Estimated Fair Value	Face Value	Number of Policies	Estimated Fair Value	Face Value
2018	7	$ 4,584,000	$ 4,889,000	8	$ 4,398,000	$ 4,689,000
2019	39	48,373,000	62,030,000	48	63,356,000	83,720,000
2020	82	82,265,000	129,005,000	87	79,342,000	127,373,000
2021	95	95,308,000	164,094,000	98	96,154,000	170,695,000
2022	113	102,343,000	202,210,000	90	85,877,000	181,120,000
2023	93	74,048,000	181,905,000	93	69,467,000	175,458,000
2024	103	78,156,000	225,134,000	100	77,638,000	228,188,000
Thereafter	410	202,312,000	788,799,000	374	174,295,000	704,905,000
Totals	942	687,389,000	1,758,066,000	898	$ 650,527,000	$ 1,676,148,000

We recognized life insurance benefits of $14,504,000 and $18,975,000 during the three months ended March 31, 2018 and 2017, respectively, related to policies with a carrying value of $5,083,000 and $2,369,000, respectively, and as a result recorded realized gains of $9,421,000 and $16,606,000.

Reconciliation of gain on life insurance policies:

	March 31, 2018	March 31, 2017
Change in estimated probabilistic cash flows	$ 19,005,000	$ 14,034,000
Unrealized gain on acquisitions	6,974,000	10,602,000
Premiums and other annual fees	(12,197,000)	(11,090,000)
Change in discount rates(1)	—	—
Change in life expectancy evaluation(2)	(4,868,000)	(1,942,000)
Face value of matured policies	14,504,000	18,975,000
Fair value of matured policies	(9,549,000)	(11,179,000)
Gain on life insurance policies, net	$ 13,869,000	$ 19,400,000

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(1) The discount rate applied to estimate the fair value of the portfolio of life insurance policies we own was 10.45% as of March 31, 2018 and 10.96% as of March 31, 2017. The carrying value of policies acquired during each quarterly reporting period is adjusted to current fair value using the fair value discount rate applied to the entire portfolio as of that reporting date.

(2) The change in fair value due to updating life expectancy estimates on certain life insurance policies in our portfolio.

We currently estimate that premium payments and servicing fees required to maintain our current portfolio of life insurance policies in force for the next five years, assuming no mortalities, are as follows:

Years Ending December 31,	Premiums		Servicing	Premiums and Servicing Fees
Nine months ending December 31, 2018	$	41,177,000	995,000	42,172,000
2019		61,480,000	1,327,000	62,807,000
2020		70,661,000	1,327,000	71,988,000
2021		80,949,000	1,327,000	82,276,000
2022		92,191,000	1,327,000	93,518,000
2023		102,177,000	1,327,000	103,504,000
	$	448,635,000	7,630,000	456,265,000

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(3) Investment in Life Insurance Policies (cont.)

Management anticipates funding the majority of the premium payments estimated above with additional borrowing capacity, created as the premiums and servicing costs of pledged life insurance policies become due, under the amended and restated senior credit facility with LNV Corporation as described in Note 6 and the net proceeds from our offering of L Bonds as described in Note 8. Management anticipates funding premiums and servicing costs of non-pledged life insurance policies with proceeds from the receipt of policy benefits from our portfolio of life insurance policies and net proceeds from our offering of L Bonds. The proceeds of these capital sources may also be used for the purchase, policy premiums and servicing costs of additional life insurance policies as well as for other working capital and financing expenditures including paying principal, interest and dividends.

(4) Fair Value Definition and Hierarchy

Accounting Standards Codification 820, Fair Value Measurements and Disclosures ("ASC 820") establishes a hierarchical disclosure framework that prioritizes and ranks the level of market price observability used in measuring assets and liabilities at fair value. Market price observability is affected by a number of factors, including the type of investment, the characteristics specific to the investment and the state of the marketplace, including the existence and transparency of transactions between market participants. Assets and liabilities with readily available and actively quoted prices, or for which fair value can be measured from actively quoted prices in an orderly market, generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

ASC 820 maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring the use of observable inputs whenever available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from independent sources. Unobservable inputs are inputs that reflect assumptions about how market participants price an asset or liability based on the best available information. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date.

The hierarchy is broken down into three levels based on the observability of inputs as follows:

- Level 1 — Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Because valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

- Level 2 — Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

- Level 3 — Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The availability of observable inputs can vary by types of assets and liabilities and is affected by a wide variety of factors, including, for example, whether an instrument is established in the marketplace, the liquidity of markets and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by management in determining fair value is greatest for assets and liabilities categorized in Level 3.

Level 3 Valuation Process

The estimated fair value of our portfolio of life insurance policies is determined on a quarterly basis by management taking into consideration changes in discount rate assumptions, estimated premium payments and life expectancy estimate assumptions, as well as any changes in economic and other relevant conditions. The discount rate incorporates current information about discount rates applied by other reporting companies owning portfolios of life insurance policies, the discount rates observed in the life insurance secondary market, market interest rates, the estimated credit

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GWG HOLDINGS, INC. AND SUBSIDIARIES

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(4) Fair Value Definition and Hierarchy (cont.)

exposure to the insurance company that issued the life insurance policy and management's estimate of the operational risk premium a purchaser would require to receive the future cash flows derived from our portfolio as a whole. Management has discretion regarding the combination of these and other factors when determining the discount rate.

These inputs are then used to estimate the discounted cash flows from the portfolio using the Model Actuarial Pricing System ("MAPS") probabilistic and stochastic portfolio pricing model, which estimates the expected cash flows using various mortality probabilities and scenarios. The valuation process includes a review by senior management as of each valuation date. We also engage MAPS to independently test the accuracy of the valuations using the inputs we provide on a quarterly basis. A copy of a letter documenting the MAPS calculation is filed as Exhibit 99.1 to this report.

The following table reconciles the beginning and ending fair value of our Level 3 investments in our portfolio of life insurance policies for the periods ended March 31, as follows:

	Three Months Ended March 31, 2018	March 31, 2017
Beginning balance	$ 650,527,000	$ 511,192,000
Purchases	25,300,000	22,690,000
Maturities (initial cost basis)	(5,083,000)	(2,369,000)
Net change in fair value	16,645,000	13,884,000
Ending balance	$ 687,389,000	$ 545,397,000

In the past, we periodically updated the life expectancy estimates on the insured lives in our portfolio, other than insured lives covered under small face amount policies (i.e., $1 million in face value benefits or less), on a continuous rotating three-year cycle, and through that effort attempted to update life expectancies for approximately one-twelfth of our portfolio each quarter. Currently, however, the terms of our senior credit facility with LNV Corporation require us to update the life expectancy estimates every two years, on policies pledged to them, beginning from the date of the amended facility.

The following table summarizes the inputs utilized in estimating the fair value of our portfolio of life insurance policies:

	As of March 31, 2018	As of December 31, 2017
Weighted-average age of insured, years*	81.9	81.7
Weighted-average life expectancy, months*	82.3	82.4
Average face amount per policy	$ 1,866,000	$ 1,867,000
Discount rate	10.45 %	10.45 %

(*) Weighted-average by face amount of policy benefits

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(4) Fair Value Definition and Hierarchy (cont.)

Life expectancy estimates and market discount rates for a portfolio of life insurance policies are inherently uncertain and the effect of changes in estimates may be significant. For example, if the life expectancy estimates were increased or decreased by four and eight months on each outstanding policy, and the discount rates were increased or decreased by 1% and 2%, with all other variables held constant, the fair value of our investment in life insurance policies would increase or decrease as summarized below:

Change in Fair Value of the Investment in Life Insurance Policies

	Change in life expectancy estimates			
	minus 8 months	minus 4 months	plus 4 months	plus 8 months
March 31, 2018	$ 91,196,000	$ 45,252,000	$ (44,850,000)	$ (88,987,000)
December 31, 2017	$ 86,391,000	$ 42,886,000	$ (42,481,000)	$ (84,238,000)

	Change in discount rate			
	minus 2%	minus 1%	plus 1%	plus 2%
March 31, 2018	$ 71,950,000	$ 34,419,000	$ (31,645,000)	$ (60,809,000)
December 31, 2017	$ 68,117,000	$ 32,587,000	$ (29,964,000)	$ (57,583,000)

Other Fair Value Considerations

The carrying value of receivables, prepaid expenses, accounts payable and accrued expenses approximate fair value due to their short-term maturities and low credit risk. Using the income-based valuation approach, the estimated fair value of our L Bonds, having an aggregate face value of $483,782,000 as of March 31, 2018, is approximately $491,724,000 based on a weighted-average market interest rate of 6.74%. The carrying value of the senior credit facility with LNV Corporation reflects interest charged at 12-month LIBOR plus an applicable margin. The margin represents our credit risk, and the strength of the portfolio of life insurance policies collateralizing the debt. The overall rate reflects market, and the carrying value of the facility approximates fair value.

GWG MCA participates in the merchant cash advance industry by directly advancing sums to merchants and lending money, on a secured basis, to companies that advance sums to merchants. Each quarter, we review the carrying value of these cash advances, and determine if an impairment reserve is necessary. At March 31, 2018 one of our secured cash advances was impaired. Specifically, the secured loan to Nulook Capital LLC had an outstanding balance of $1,938,000 and a loan loss reserve of $1,908,000 at March 31, 2018. We deem fair value to be the estimated collectible value on each loan or advance made from GWG MCA. Where we estimate the collectible amount to be less than the outstanding balance, we record a reserve for the difference, referred to as an impairment charge. We did not record an impairment charge in the three months periods ended March 31, 2018 or March 31, 2017.

The following table summarizes outstanding warrants (discussed in Note 13) as of March 31, 2018:

Month issued	Warrants issued	Fair value per share	Risk free rate	Volatility	Term
September 2014	16,000	$ 1.26	1.85 %	17.03 %	5 years
	16,000				

(5) Credit Facility — Autobahn Funding Company LLC

On September 12, 2017, we terminated our $105 million senior credit facility with Autobahn Funding Company LLC, the Credit and Security Agreement governing the facility as well as the related pledge agreement, pursuant to which our obligations under the facility were secured. We paid off in full all obligations under the facility on September 14, 2016, and since that date, we have had no amounts outstanding under the facility.

The Credit and Security Agreement contained certain financial and non-financial covenants, and we were in compliance with these covenants during the year ended December 31, 2017 until the date of termination.

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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(6) Credit Facility — LNV Corporation

On September 27, 2017, we entered into an amended and restated senior credit facility with LNV Corporation as lender through our subsidiary GWG DLP Funding IV, LLC ("DLP IV"). The Amended and Restated Loan Agreement governing the facility makes available a total of up to $300,000,000 in credit with a maturity date of September 27, 2029. Additional advances are available under the Amended and Restated Loan Agreement at the LIBOR rate as defined in the Amended and Restated Loan Agreement. Advances are available as the result of additional borrowing base capacity, created as the premiums and servicing costs of pledged life insurance policies become due. Interest will accrue on amounts borrowed under the Amended and Restated Loan Agreement at an annual interest rate, determined as of each date of borrowing or quarterly if there is no borrowing, equal to (A) the greater of 12-month LIBOR or the federal funds rate (as defined in the agreement) plus one-half of one percent per annum, plus (B) 7.50% per annum. The effective rate at March 31, 2018 was 9.63%. Interest payments are made on a quarterly basis.

As of March 31, 2018, approximately 78.1% of the total face value of our portfolio is pledged to LNV Corporation. The amount outstanding under this facility was $219,470,000 and $222,525,000 at March 31, 2018 and December 31, 2017, respectively. Obligations under the facility are secured by a security interest in DLP IV's assets, for the benefit of the lenders under the Amended and Restated Loan Agreement, through an arrangement under which Wells Fargo serves as securities intermediary. The life insurance policies owned by DLP IV do not serve as direct collateral for the obligations of GWG Holdings under the L Bonds. The difference between the amount outstanding and the carrying amount on our condensed consolidated balance sheets is due to netting of unamortized debt issuance costs.

The Amended and Restated Loan Agreement has certain financial and nonfinancial covenants, and we were in compliance with these covenants at March 31, 2018 and December 31, 2017.

(7) Series I Secured Notes

Series I Secured Notes were legal obligations of GWG Life and were privately offered and sold from August 2009 through June 2011. On September 8, 2017, we redeemed all outstanding Series I Secured Notes for an aggregate of $6,815,000.

(8) L Bonds

Our L Bonds are legal obligations of GWG Holdings. Obligations under the L Bonds are secured by the assets of GWG Holdings and by GWG Life, as a guarantor, and are subordinate to the obligations under our senior credit facility (see Note 6). We began publicly offering and selling L Bonds in January 2012 under the name "Renewable Secured Debentures". These debt securities were re-named "L Bonds" in January 2015. L Bonds are publicly offered and sold on a continuous basis under a registration statement permitting us to sell up to $1.0 billion in principal amount of L Bonds. On December 1, 2017, an additional public offering was declared effective permitting us to sell up to $1.0 billion in principal amount of L Bonds on a continuous basis. The new offering is a follow-on to the previous L Bond offering and contains the same terms and features. We are party to an indenture governing the L Bonds dated October 19, 2011, as amended ("Indenture"), under which GWG Holdings is obligor, GWG Life is guarantor, and Bank of Utah serves as indenture trustee. The Indenture contains certain financial and non-financial covenants, and we were in compliance with these covenants at March 31, 2018 and December 31, 2017.

The bonds have renewal features under which we may elect to permit their renewal, subject to the right of bondholders to elect to receive payment at maturity. Interest is payable monthly or annually depending on the election of the investor.

At March 31, 2018 and December 31, 2017, the weighted-average interest rate of our L Bonds was 7.24% and 7.29%, respectively. The principal amount of L Bonds outstanding was $483,782,000 and $461,427,000 at March 31, 2018 and December 31, 2017, respectively. The difference between the amount of outstanding L Bonds and the carrying amount on our condensed consolidated balance sheets is due to netting of unamortized deferred issuance costs, cash receipts for new issuances and payments of redemptions in process. Amortization of deferred issuance costs were $1,999,000 and $1,929,000 for the three months ended March 31, 2018 and 2017, respectively. Future expected amortization of deferred financing costs as of March 31, 2018 is $16,214,000 in total over the next seven years.

GWG HOLDINGS, INC. AND SUBSIDIARIES

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(8) L Bonds (cont.)

Future contractual maturities of L Bonds, and future amortization of their deferred financing costs, at March 31, 2018 are as follows:

Years Ending December 31,	Contractual Maturities	Amortization of Deferred Financing Costs
Nine months ending December 31, 2018	$ 80,988,000	$ 699,000
2019	151,102,000	3,753,000
2020	93,940,000	3,605,000
2021	44,460,000	1,934,000
2022	39,938,000	2,015,000
2023	26,389,000	1,402,000
Thereafter	46,965,000	2,806,000
	$ 483,782,000	$ 16,214,000

(9) Series A Convertible Preferred Stock

From July 2011 through September 2012, we privately offered shares of Series A of GWG Holdings at $7.50 per share. In the offering, we sold an aggregate of 3,278,000 shares for gross consideration of $24,582,000. Holders of Series A were entitled to cumulative dividends at the rate of 10% per annum, paid quarterly. The Series A Convertible Preferred Stock were only redeemable at our option.

Purchasers of Series A in our offering received warrants to purchase an aggregate of 416,000 shares of our common stock at an exercise price of $12.50 per share. As of March 31, 2018 and December 31, 2017, all of these warrants have expired and none of them had been exercised.

On October 9, 2017 all shares of Series A were redeemed with a redemption payment equal to the sum of: (i) $8.25 per Series A share and (ii) all accrued but unpaid dividends.

(10) Redeemable Preferred Stock

On November 30, 2015, our public offering of up to 100,000 shares of Redeemable Preferred Stock (“RPS”) at $1,000 per share was declared effective. Holders of RPS are entitled to cumulative dividends at the rate of 7% per annum, paid monthly. Dividends on the RPS are recorded as a reduction to additional paid-in capital, if any, then to the outstanding balance of the preferred stock if additional paid-in-capital has been exhausted. Under certain circumstances described in the Certificate of Designation for the RPS, additional shares of RPS may be issued in lieu of cash dividends.

The RPS ranks senior to our common stock and pari passu with our RPS 2 and entitles its holders to a liquidation preference equal to the stated value per share (i.e., $1,000) plus accrued but unpaid dividends. Holders of RPS may presently convert their RPS into our common stock at a conversion price equal to the volume-weighted average price of our common stock for the 20 trading days immediately prior to the date of conversion, subject to a minimum conversion price of $15.00 and in an aggregate amount limited to 15% of the stated value of RPS originally purchased by such holder from us and still held by such holder.

Holders of RPS may request that we redeem their RPS at a price equal to their stated value plus accrued but unpaid dividends, less an applicable redemption fee, if any. Nevertheless, the Certificate of Designation for RPS permits us sole discretion to grant or decline redemption requests. Subject to certain restrictions and conditions, we may also redeem shares of RPS without a redemption fee upon a holder's death, total disability or bankruptcy. In addition, after one year from the date of original issuance, we may, at our option, call and redeem shares of RPS at a price equal to their liquidation preference.

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(10) Redeemable Preferred Stock (cont.)

As of March 31, 2017, we closed the RPS offering to investors having sold 99,127 shares of RPS for an aggregate gross consideration of $99,127,000 and incurred approximately $7,019,000 of related selling costs.

At the time of its issuance, we determined that the RPS contained two embedded features: (1) optional redemption by the holder and (2) optional conversion by the holder. We determined that each of the embedded features met the definition of a derivative and that the RPS should be considered an equity host for the purposes of assessing the embedded derivatives for potential bifurcation. Based on our assessment under Accounting Standards Codification 470 “Debt” (“ASC 470”) we do not believe bifurcation of either the holder’s redemption or conversion feature is appropriate.

(11) Series 2 Redeemable Preferred Stock

On February 14, 2017, our public offering up to 150,000 shares of Series 2 Redeemable Preferred Stock (“RPS 2”) at $1,000 per share was declared effective. Holders of RPS 2 are entitled to cumulative dividends at the rate of 7% per annum, paid monthly. Dividends on the RPS 2 are recorded as a reduction to additional paid-in capital, if any, then to the outstanding balance of the preferred stock if additional paid-in capital has been exhausted. Under certain circumstances described in the Certificate of Designation for the RPS 2, additional shares of RPS 2 may be issued in lieu of cash dividends.

The RPS 2 ranks senior to our common stock and pari passu with our RPS and entitles its holders to a liquidation preference equal to the stated value per share (i.e., $1,000) plus accrued but unpaid dividends. Holders of RPS 2 may, less an applicable conversion discount, if any, convert their RPS 2 into our common stock at a conversion price equal to the volume-weighted average price of our common stock for the 20 trading days immediately prior to the date of conversion, subject to a minimum conversion price of $12.75 and in an aggregate amount limited to 10% of the stated value of RPS 2 originally purchased by such holder from us and still held by such holder.

Holders of RPS 2 may request that we redeem their RPS 2 shares at a price equal to their liquidation preference, less an applicable redemption fee, if any. Nevertheless, the Certificate of Designation for RPS 2 permits us sole discretion to grant or decline requests for redemption. Subject to certain restrictions and conditions, we may also redeem shares of RPS 2 without a redemption fee upon a holder’s death, total disability or bankruptcy. In addition, we may, at our option, call and redeem shares of RPS 2 at a price equal to their liquidation preference (subject to a minimum redemption price, in the event of redemptions occurring less than one year after issuance, of 107% of the stated value of the shares being redeemed).

As of March 31, 2018, we had sold 135,276 shares of RPS 2 for aggregate gross consideration of $135,276,000 and incurred approximately $9,300,000 of selling costs related to the sale of those shares. Subsequent to March 31, 2018, we closed the RPS 2 offering to additional investors in April 2018.

At the time of its issuance, we determined that the RPS 2 contained two embedded features: (1) optional redemption by the holder; and (2) optional conversion by the holder. We determined that each of the embedded features met the definition of a derivative and that the RPS 2 should be considered an equity host for the purposes of assessing the embedded derivatives for potential bifurcation. Based on our assessment under ASC 470 we do not believe bifurcation of either the holder’s redemption or conversion feature is appropriate.

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(12) Income Taxes

We had a current income tax liability of $0 as of both March 31, 2018 and December 31, 2017. The components of our income tax expense (benefit) and the reconciliation at the statutory federal tax rate to our actual income tax expense (benefit) for the three months ended March 31, 2018 and 2017 consisted of the following:

	Three Months Ended March 31, 2018		Three Months Ended March 31, 2017	
Statutory federal income tax (benefit)	$ (1,928,000)	21.0 %	$ (15,500)	34.0 %
State income taxes (benefit), net of federal benefit	(701,000)	7.6 %	(1,000)	3.1 %
Change in valuation allowance	2,604,000	(28.4)%	—	- %
Other permanent differences	25,000	(0.2)%	16,000	(36.0)%
Total income tax expense (benefit)	$ —	—	$ (500)	1.1 %

The tax effects of temporary differences that give rise to deferred income taxes were as follows:

	As of March 31, 2018	As of December 31, 2017
Deferred tax assets:		
Note Receivable from related party	$ 1,437,000	$ 1,437,000
Net operating loss carryforwards	11,445,000	9,995,000
Other assets	1,641,000	1,724,000
Subtotal	$ 14,523,000	$ 13,156,000
Valuation allowance	(8,990,000)	(6,386,000)
Deferred tax assets	$ 5,533,000	$ 6,770,000
Deferred tax liabilities:		
Investment in life insurance policies	$ (5,414,000)	$ (6,630,000)
Other liabilities	(119,000)	(140,000)
Net deferred tax asset (liability)	$ —	$ —

At March 31, 2018 and December 31, 2017, we had federal net operating loss ("NOL") carryforwards of $39,820,000 and $34,775,000, respectively. The NOL carryforwards will begin to expire in 2031. Future utilization of NOL carryforwards is subject to limitations under Section 382 of the Internal Revenue Code. This section generally relates to a more than 50 percent change in ownership over a three-year period. We currently do not believe that any prior issuance of common stock has resulted in an ownership change under Section 382 through March 31, 2018.

We provide for a valuation allowance when it is not considered "more likely than not" that our deferred tax assets will be realized. As of March 31, 2018, based on all available evidence, we have provided a valuation allowance against our total net deferred tax asset of $8,990,000 due to uncertainty as to the realization of our deferred tax assets during the carryforward periods.

On December 22, 2017, the U.S. federal government enacted the Tax Cuts and Jobs Act ("Tax Reform Bill"). The Tax Reform Bill changed existing United States tax law, including a reduction of the U.S. corporate income tax rate. The

Company re-measured deferred taxes as of the date of enactment, reflecting those changes within deferred tax assets as of December 31, 2017.

ASC 740 requires the reporting of certain tax positions that do not meet a threshold of “more-likely-than-not” to be recorded as uncertain tax benefits. It is management’s responsibility to determine whether it is “more-likely-than-not” that a tax position will be sustained upon examination, including resolution of any related appeals or litigation, based upon the technical merits of the position. Management has reviewed all income tax positions taken or expected to be

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GWG HOLDINGS, INC. AND SUBSIDIARIES

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(12) Income Taxes (cont.)

taken for all open years and has determined that the income tax positions are appropriately stated and supported. We do not anticipate that the total unrecognized tax benefits will significantly change prior to December 31, 2018.

Under our accounting policies, interest and penalties on unrecognized tax benefits, as well as interest received from favorable tax settlements are recognized as components of income tax expense. At March 31, 2018 and December 31, 2017, we recorded no accrued interest or penalties related to uncertain tax positions.

Our income tax returns for tax years ended December 31, 2014, 2015, 2016 and 2017, when filed, remain open to examination by the Internal Revenue Service and various state taxing jurisdictions. Our income tax return for tax year ended December 31, 2013 also remains open to examination by various state taxing jurisdictions.

(13) Common Stock

In September 2014, we consummated an initial public offering of our common stock resulting in the sale of 800,000 shares of common stock at $12.50 per share, and net proceeds of approximately $8.6 million after the payment of underwriting commissions, discounts and expense reimbursements. In connection with this offering, we listed our common stock on the Nasdaq Capital Market under the ticker symbol “GWGH.”

In conjunction with the initial public offering our Company issued warrants to purchase 16,000 shares of common stock at an exercise price of $15.63 per share. As of March 31, 2018, none of these warrants had been exercised. The remaining life of these warrants at March 31, 2018 was 1.5 years.

(14) Stock Incentive Plan

We adopted our 2013 Stock Incentive Plan in March 2013, as amended on June 1, 2015 and May 5, 2017. The Compensation Committee of our Board of Directors is responsible for the administration of the plan. Participants under the plan may be granted incentive stock options and non-statutory stock options; stock appreciation rights; stock awards; restricted stock; restricted stock units; and performance shares. Eligible participants include officers and employees of GWG Holdings and its subsidiaries, members of our Board of Directors, and consultants. Awards generally expire 10 years from the date of grant. As of March 31, 2018, 3,000,000 common stock options are authorized under the plan, of which 869,830 remain available for issuance.

On May 8, 2018 our common shareholders approved an amendment to our 2013 Stock Incentive Plan increasing the total awards issuable under the plan to 6,000,000.

Stock Options

As of March 31, 2018, we had outstanding stock options for 1,609,000 shares of common stock to employees, officers, and directors under the plan. Options for 945,000 shares have vested, and the remaining options are scheduled to vest over three years. The options were issued with an exercise price between $6.35 and $10.38 for those beneficially owning more than 10% of our common stock, and between $4.83 and $11.00 for all others, which is equal to the market price of the shares on the date of grant. The expected annualized volatility used in the Black-Scholes model valuation of options issued during the three months ended March 31, 2018 was 20.5%. The annual volatility rate is based on the standard deviation of the average continuously compounded rate of return of five selected comparable companies. As of March 31, 2018, stock options for 693,000 shares had been forfeited and stock options for 178,000 shares had been exercised.

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(14) Stock Incentive Plan (cont.)

Outstanding stock options:

	Vested	Un-vested	Total
Balance as of December 31, 2016	738,065	844,334	1,582,399
Granted during the year	61,099	367,500	428,599
Vested during the year	327,061	(327,061)	—
Exercised during the year	(126,498)	—	(126,498)
Forfeited during the year	(142,535)	(105,017)	(247,552)
Balance as of December 31, 2017	857,192	779,756	1,636,948
Granted during the quarter	1,000	3,000	4,000
Vested during the quarter	111,006	(111,006)	—
Exercised during the quarter	(23,834)	—	(23,834)
Forfeited during the quarter	(750)	(7,499)	(8,249)
Balance as of March 31, 2018	944,614	664,251	1,608,865

As of March 31, 2018, unrecognized compensation expense related to un-vested options is $935,000. We expect to recognize this compensation expense over the next three years ($410,000 in 2018, $399,000 in 2019, $125,000 in 2020, and $1,000 in 2021).

Stock Appreciation Rights (SARs)

As of March 31, 2018, we had outstanding SARs for 343,000 shares of the common stock to employees. The strike price of the SARs was between $7.84 and $10.38, which was equal to the market price of the common stock at the date of issuance. As of March 31, 2018, 194,000 of the SARs were vested. On March 31, 2018, the market price of GWG's common stock was $8.50.

Outstanding SARs:

	Vested	Un-vested	Total
Balance as of December 31, 2016	106,608	133,127	239,735
Granted during the year	13,001	91,986	104,987
Vested during the year	69,444	(69,444)	—
Forfeited during the year	—	(1,750)	(1,750)
Balance as of December 31, 2017	189,053	153,919	342,972
Granted during the quarter	—	—	—
Vested during the quarter	13,392	(13,392)	—
Forfeited during the quarter	—	—	—
Balance as of March 31, 2018	202,445	140,527	342,972

The liability for the SARs as of March 31, 2018 and December 31, 2017 was $601,000 and $551,000, respectively, and was recorded within other accrued expenses on the condensed consolidated balance sheets. Employee compensation and benefits expense for SARs of $50,000 and $289,000 was recorded for the three months ended March 31, 2018 and 2017, respectively.

Upon the exercise of SARs, the Company is obligated to make cash payment equal to the positive difference between the fair market value of the Company’s common stock on the date of exercise less the fair market value of the common stock on the date of grant.

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(14) Stock Incentive Plan (cont.)

The following summarizes information concerning outstanding shares issuable under the 2013 Stock Incentive Plan:

	March 31, 2018			
	Outstanding	Weighted-Average Exercise Price	Weighted-Average Remaining Life (years)	Fair Value at Grant Date
Vested				
Stock Options	944,614	$ 8.13	6.07	$ 1.78
SARs	202,445	$ 8.62	5.63	$ 1.89
Total Vested	1,147,059	$ 8.22	5.99	$ 1.80
Unvested				
Stock Options	664,251	$ 9.32	7.21	$ 2.21
SARs	140,527	$ 9.11	6.01	$ 2.06
Total Unvested	804,778	$ 9.28	7.00	$ 2.19

	December 31, 2017			
	Outstanding	Weighted-Average Exercise Price	Weighted-Average Remaining Life (years)	Fair Value at Grant Date
Vested				
Stock Options	857,192	$ 8.05	6.17	$ 1.76
SARs	189,053	$ 8.54	5.86	$ 1.90
Total Vested	1,046,245	$ 8.14	6.11	$ 1.78
Unvested				
Stock Options	779,756	$ 9.21	7.50	$ 2.17
SARs	153,919	$ 9.16	6.24	$ 2.02
Total Unvested	933,675	$ 9.21	7.30	$ 2.15

(15) Other Expenses

The components of other expenses in our condensed consolidated statements of operations for the three months ended March 31, 2018 and 2017 are as follows:

	Three Months Ended March 31, 2018	March 31, 2017
Contract labor	$ 300,000	$ 95,000
Marketing	421,000	552,000
Information technology	500,000	331,000
Servicing and facility fees	394,000	227,000
Travel and entertainment	217,000	235,000

Insurance and regulatory		367,000		378,000
Charitable contributions		—		331,000
General and administrative		542,000		631,000
Total other expenses	$	2,741,000	$	2,780,000

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(16) Net Loss Attributable to Common Shareholders

We have outstanding RPS and RPS 2, as described in Notes 10 and 11. RPS and RPS 2 are anti-dilutive to our net loss attributable to common shareholders calculation for both the three months ended March 31, 2018 and 2017. Our vested and un-vested stock options are anti-dilutive for both the three months ended March 31, 2018 and 2017.

(17) Commitments

We are party to an office lease with U.S. Bank National Association as the landlord. On September 1, 2015, we entered into an amendment to our original lease that expanded the leased space to 17,687 square feet and extended the term through October 2025. Under the amended lease we are obligated to pay base rent plus common area maintenance and a share of building operating costs. Rent expenses under this agreement were $104,000 and $113,000 during the three months ended March 31, 2018 and 2017, respectively.

Minimum lease payments under the amended lease are as follows:

Nine months ending December 31, 2018	$ 199,000
2019	275,000
2020	284,000
2021	293,000
2022	302,000
2023	311,000
Thereafter	593,000
	$ 2,257,000

(18) Contingencies

Litigation — In the normal course of business, we are involved in various legal proceedings. In the opinion of management, any liability resulting from such proceedings would not have a material adverse effect on our financial position, results of operations or cash flows.

(19) Guarantee of L Bonds

We are publicly offering and selling L Bonds under a registration statement declared effective by the SEC, as described in Note 8. Our obligations under the L Bonds are secured by substantially all the assets of GWG Holdings, a pledge of all our common stock held individually by our largest stockholders, and by a guarantee and corresponding grant of a security interest in substantially all the assets of GWG Life. As a guarantor, GWG Life has fully and unconditionally guaranteed the payment of principal and interest on the L Bonds. GWG Life's equity in DLP IV serve as collateral for our L Bond obligations. Substantially all of our life insurance policies are held by DLP IV and the Trust. The policies held by DLP IV are not collateral for the L Bond obligations as such policies are pledged to the senior credit facility with LNV Corporation.

The consolidating financial statements are presented in lieu of separate financial statements and other related disclosures of the subsidiary guarantor and issuer, because management does not believe that separate financial statements and related disclosures would be material to investors. There are currently no significant restrictions on the ability of GWG Holdings or GWG Life, the guarantor subsidiary, to obtain funds from its subsidiaries by dividend or loan, except as described in these notes. A substantial majority of insurance policies we currently own are subject to a collateral arrangement with LNV Corporation described in Note 6. Under this arrangement, we are required to maintain a collection account that is used to collect policy benefits from pledged policies, pay interest and other charges under the facility, and distribute funds to pay down the facility.

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(19) Guarantee of L Bonds (cont.)

The following represents condensed consolidating financial information as of March 31, 2018 and December 31, 2017, with respect to the financial position, and as of March 31, 2018 and 2017, with respect to results of operations and cash flows of GWG Holdings and its subsidiaries. The parent column presents the financial information of GWG Holdings, the primary obligor for the L Bonds. The guarantor subsidiary column presents the financial information of GWG Life, the guarantor subsidiary of the L Bonds, presenting its investment in DLP IV and the Trust under the equity method. The non-guarantor subsidiaries column presents the financial information of all non-guarantor subsidiaries, including DLP IV and the Trust.

Condensed Consolidating Balance Sheets

March 31, 2018	**Parent**	**Guarantor Subsidiary**	**Non-Guarantor Subsidiaries**	**Eliminations**	**Consolidated**
			ASSETS		
Cash and cash equivalents	$ 139,933,398	$ 341,297	$ 938,212	$ —	$ 141,212,907
Restricted cash	—	4,817,673	11,734,583	—	16,552,256
Investment in life insurance policies, at fair value	—	51,965,002	635,424,477	—	687,389,479
Secured MCA advances	—	—	1,639,818	—	1,639,818
Life insurance policy benefits receivable	—	200,000	12,102,730	—	12,302,730
Other assets	2,161,944	1,987,778	3,252,595	—	7,402,317
Investment in subsidiaries	505,032,023	446,192,147	—	(951,224,170)	—
TOTAL ASSETS	$ 647,127,365	$ 505,503,897	$ 665,092,415	$ (951,224,170)	$ 866,499,507
			LIABILITIES & STOCKHOLDERS' EQUITY		
LIABILITIES					
Senior credit facility with LNV Corporation	$ —	$ —	$ 209,447,613	$ —	$ 209,447,613
L Bonds	469,729,977	—	—	—	469,729,977
Accounts payable	1,162,330	755,163	1,694,407	—	3,611,900
Interest and dividends payable	10,719,337	—	5,176,930	—	15,896,267
Other accrued expenses	1,768,734	1,788,077	509,952	—	4,066,763
TOTAL LIABILITIES	483,380,378	2,543,240	216,828,902	—	702,752,520

STOCKHOLDERS' EQUITY					
Member capital	—	502,960,657	448,263,513	(951,224,170)	—
Redeemable preferred stock and Series 2 redeemable preferred stock	212,369,231	—	—	—	212,369,231
Common stock	5,813	—	—	—	5,813
Accumulated deficit	(48,628,057)	—	—	—	(48,628,057)
TOTAL STOCKHOLDERS' EQUITY	163,746,987	502,960,657	448,263,513	(951,224,170)	163,746,987
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 647,127,365	$ 505,503,897	$ 665,092,415	$ (951,224,170)	$ 866,499,507

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GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(19) Guarantee of L Bonds (cont.)

Condensed Consolidating Balance Sheets (continued)

December 31, 2017	**Parent**	**Guarantor Subsidiary**	**Non-Guarantor Subsidiaries**	**Eliminations**	**Consolidated**
ASSETS					
Cash and cash equivalents	$ 111,952,829	$ 1,486,623	$ 982,039	$ —	$ 114,421,491
Restricted cash	—	9,367,410	18,982,275	—	28,349,685
Investment in life insurance policies, at fair value	—	51,093,362	599,433,991	—	650,527,353
Secured MCA advances	—	—	1,661,774	—	1,661,774
Life insurance policy benefits receivable	—	1,500,000	15,158,761	—	16,658,761
Other assets	1,912,203	1,986,312	3,338,595	—	7,237,110
Investment in subsidiaries	480,659,789	415,235,212	—	(895,895,001)	—
TOTAL ASSETS	$ 594,524,821	$ 480,668,919	$ 639,557,435	$ (895,895,001)	$ 818,856,174
LIABILITIES & STOCKHOLDERS' EQUITY					
LIABILITIES					
Senior credit facility with LNV Corporation	$ —	$ —	$ 212,238,192	$ —	$ 212,238,192
L Bonds	447,393,568	—	—	—	447,393,568
Accounts payable	1,434,623	844,899	4,114,917	—	6,394,439
Interest and dividends payable	10,296,584	—	5,130,925	—	15,427,509
Other accrued expenses	1,728,303	1,610,773	391,647	—	3,730,723
TOTAL LIABILITIES	460,853,078	2,455,672	221,875,681	—	685,184,431
STOCKHOLDERS' EQUITY					
Member capital	—	478,213,247	417,681,754	(895,895,001)	—
Redeemable preferred stock and Series 2 redeemable preferred stock	173,115,447	—	—	—	173,115,447
Common stock	5,813	—	—	—	5,813
Accumulated deficit	(39,449,517)	—	—	—	(39,449,517)

TOTAL STOCKHOLDERS' EQUITY	133,671,743	478,213,247	417,681,754	(895,895,001)	133,671,743
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 594,524,821	$ 480,668,919	$ 639,557,435	$ (895,895,001)	$ 818,856,174

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GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(19) Guarantee of L Bonds (cont.)

Condensed Consolidating Statements of Operations

For the three months ended March 31, 2018	**Parent**	**Guarantor Subsidiary**	**Non-Guarantor Subsidiaries**	**Eliminations**	**Consolidated**
REVENUE					
Gain on life insurance policies, net	$ —	$ 1,393,455	$ 12,475,290	$ —	$ 13,868,745
MCA income	—	—	66,810	—	66,810
Interest and other income	452,039	8,726	145,352	—	606,117
TOTAL REVENUE	452,039	1,402,181	12,687,452	—	14,541,672
EXPENSES					
Interest expense	10,622,652	—	5,440,685	—	16,063,337
Employee compensation and benefits	1,922,733	1,475,731	344,205	—	3,742,669
Legal and professional fees	407,312	231,650	534,667	—	1,173,629
Other expenses	1,794,480	464,607	481,490	—	2,740,577
TOTAL EXPENSES	14,747,177	2,171,988	6,801,047	—	23,720,212
INCOME (LOSS) BEFORE EQUITY IN INCOME OF SUBSIDIARIES	(14,295,138)	(769,807)	5,886,405	—	(9,178,540)
EQUITY IN INCOME OF SUBSIDIARIES	5,116,598	6,864,200	—	(11,980,798)	—
NET INCOME (LOSS) BEFORE INCOME TAXES	(9,178,540)	6,094,393	5,886,405	(11,980,798)	(9,178,540)
INCOME TAX BENEFIT	—	—	—	—	—
NET INCOME (LOSS)	(9,178,540)	6,094,393	5,886,405	(11,980,798)	(9,178,540)
Preferred stock dividends	3,704,484	—	—	—	3,704,484
NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS	$ (12,883,024)	$ 6,094,393	$ 5,886,405	$ (11,980,798)	$ (12,883,024)

For the three months ended March 31, 2017	Parent	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUE					
Gain on life insurance policies, net	$ —	$ 1,499,327	$ 17,900,492	$ —	$ 19,399,819

MCA income	—	—	246,577	—	246,577
Interest and other income	85,008	71,900	379,086	(94,045)	441,949
TOTAL REVENUE	85,008	1,571,227	18,526,155	(94,045)	20,088,345
EXPENSES					
Interest expense	9,262,034	286,354	3,736,847	(41,020)	13,244,215
Employee compensation and benefits	1,928,796	1,221,582	12,684	—	3,163,062
Legal and professional fees	492,816	261,087	192,445	—	946,348
Other expenses	1,663,002	882,731	287,614	(53,025)	2,780,322
TOTAL EXPENSES	13,346,648	2,651,754	4,229,590	(94,045)	20,133,947
INCOME (LOSS) BEFORE EQUITY IN INCOME OF SUBSIDIARIES	(13,261,640)	(1,080,527)	14,296,565	—	(45,602)
EQUITY IN INCOME OF SUBSIDIARIES	13,216,038	14,064,207	—	(27,280,245)	—
NET INCOME (LOSS) BEFORE INCOME TAXES	(45,602)	12,983,680	14,296,565	(27,280,245)	(45,602)
INCOME TAX BENEFIT	(500)	—	—	—	(500)
NET INCOME (LOSS)	(45,102)	12,983,680	14,296,565	(27,280,245)	(45,102)
Preferred stock dividends	1,867,760	—	—	—	1,867,760
NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS	$ (1,912,862)	$ 12,983,680	$ 14,296,565	$ (27,280,245)	$ (1,912,862)

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GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(19) Guarantee of L Bonds (cont.)

Condensed Consolidating Statements of Cash Flows

For the three months ended March 31, 2018	**Parent**	**Guarantor Subsidiary**	**Non-Guarantor Subsidiary**	**Eliminations**	**Consolidated**
CASH FLOWS FROM OPERATING ACTIVITIES					
Net income (loss)	$ (9,178,540)	$ 6,094,393	$ 5,886,405	$ (11,980,798)	$ (9,178,540)
Adjustments to reconcile net income (loss) to net cash flows from operating activities:					
Equity of subsidiaries	(5,116,598)	(6,864,200)	—	11,980,798	—
Changes in fair value of life insurance policies	—	(1,512,185)	(15,133,409)	—	(16,645,594)
Amortization of deferred financing and issuance costs	1,999,433	—	263,755	—	2,263,188
(Increase) decrease in operating assets:					
Life insurance policy benefits receivable	—	1,300,000	3,056,031	—	4,356,031
Other assets	(19,505,377)	(24,094,201)	86,000	43,348,371	(165,207)
Increase (decrease) in operating liabilities:					
Accounts payable and other accrued expenses	690,234	87,568	(2,323,010)	—	(1,545,208)
NET CASH FLOWS USED IN OPERATING ACTIVITIES	(31,110,848)	(24,988,625)	(8,164,228)	43,348,371	(20,915,330)
CASH FLOWS FROM INVESTING ACTIVITIES					
Investment in life insurance policies	—	—	(25,299,825)	—	(25,299,825)
Carrying value of matured life insurance policies	—	640,545	4,442,749	—	5,083,294
Proceeds from Secured MCA advances	—	—	88,766	—	88,766
NET CASH FLOWS PROVIDED BY (USED IN) INVESTING	—	640,545			

ACTIVITIES