WESTWOOD HOLDINGS GROUP INC
Form 10-Q
July 30, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2014

OR

¨ 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 1-31234

WESTWOOD HOLDINGS GROUP, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	75-2969997
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
200 CRESCENT COURT, SUITE 1200	
DALLAS, TEXAS	75201
(Address of principal executive office)	(Zip Code)

(214) 756-6900

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 x 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).

Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and " smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

Shares of common stock, par value $0.01 per share, outstanding as of July 25, 2014: 8,288,414.

WESTWOOD HOLDINGS GROUP, INC.

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WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value and share amounts)

	June 30, 2014 (unaudited)	December 31, 2013
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 16,063	$ 10,864
Accounts receivable	16,685	14,468
Investments, at fair value	57,772	64,554
Deferred income taxes	1,313	3,782
Prepaid income taxes	2,083	—
Other assets	1,620	2,521
Total current assets	95,536	96,189
Goodwill	11,255	11,255
Deferred income taxes	2,116	2,041
Intangible assets, net	3,610	3,789
Property and equipment, net of accumulated depreciation of $2,445 and $2,155	2,676	2,746
Total assets	$ 115,193	$ 116,020
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable and accrued liabilities	$ 1,916	$ 2,082
Dividends payable	4,167	3,935
Compensation and benefits payable	8,925	17,805
Income taxes payable	—	1,031
Total current liabilities	15,008	24,853
Accrued dividends	994	1,266
Deferred rent	1,196	1,268
Total long-term liabilities	2,190	2,534
Total liabilities	17,198	27,387
Commitments and contingencies (Note 11)		
Stockholders' Equity:		
Common stock, $0.01 par value, authorized 25,000,000 shares, issued 8,989,877 and outstanding 8,288,414 shares at June 30, 2014; issued 8,778,613 and outstanding 8,176,417 shares at December 31, 2013	90	88
Additional paid-in capital	108,846	100,955
Treasury stock, at cost - 701,463 shares at June 30, 2014; 602,196 shares at December 31, 2013	(29,008)	(23,169)
Accumulated other comprehensive loss	(279)	(257)
Retained earnings	18,346	11,016

Total stockholders' equity	97,995	88,633
Total liabilities and stockholders' equity	$ 115,193	$ 116,020

See notes to condensed consolidated financial statements.

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WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except per share data and share amounts)

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
REVENUES:				
Advisory fees				
Asset based	$22,095	$16,486	$42,484	$32,033
Performance based	3,443	2,535	3,806	2,535
Trust fees	5,151	4,574	10,179	8,791
Other, net	216	(120)	385	216
Total revenues	30,905	23,475	56,854	43,575
EXPENSES:				
Employee compensation and benefits	12,502	11,907	25,045	23,750
Sales and marketing	375	334	662	621
Westwood mutual funds	722	462	1,374	866
Information technology	1,014	678	1,729	1,334
Professional services	1,189	1,077	2,571	2,079
General and administrative	1,384	1,284	2,832	2,473
Total expenses	17,186	15,742	34,213	31,123
Income before income taxes	13,719	7,733	22,641	12,452
Provision for income taxes	4,897	2,854	8,060	4,740
Net income	$8,822	$4,879	$14,581	$7,712
Other comprehensive income (loss):				
Foreign currency translation adjustments	332	(158)	(22)	(235)
Total comprehensive income	$9,154	$4,721	$14,559	$7,477
Earnings per share:				
Basic	$1.17	$0.66	$1.94	$1.05
Diluted	$1.14	$0.65	$1.89	$1.03
Weighted average shares outstanding:				
Basic	7,523,347	7,349,868	7,499,016	7,318,688
Diluted	7,739,150	7,495,523	7,720,425	7,492,392

See notes to condensed consolidated financial statements.

WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

For the Six Months Ended June 30, 2014

(in thousands, except share amounts)

(unaudited)

	Common Stock, Par Shares	Amount	Additional Paid-In Capital	Treasury Stock	Accumulated Other Comprehensive Loss	Retained Earnings	Total
BALANCE, January 1, 2014	8,176,417	$ 88	$ 100,955	$ (23,169)	$ (257)	$ 11,016	$ 88,633
Net income	—	—	—	—	—	14,581	14,581
Other comprehensive loss	—	—	—	—	(22)	—	(22)
Issuance of restricted stock, net	211,264	2	(2)	—	—	—	—
Dividends declared ($0.44 per share)	—	—	—	—	—	(7,251)	(7,251)
Restricted stock amortization	—	—	5,796	—	—	—	5,796
Reclassification of compensation liability to be paid in shares	—	—	170	—	—	—	170
Tax benefit related to equity compensation	—	—	1,927	—	—	—	1,927
Purchase of treasury stock	(99,267)	—	—	(5,839)	—	—	(5,839)
BALANCE, June 30, 2014	8,288,414	$ 90	$ 108,846	$ (29,008)	$ (279)	$ 18,346	$ 97,995

See notes to condensed consolidated financial statements.

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WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	For the six months ended June 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$14,581	$7,712
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	288	187
Amortization of intangible assets	180	180
Unrealized (gains) losses on trading investments	(134)	639
Restricted stock amortization	5,796	5,692
Deferred income taxes	2,389	937
Excess tax benefits from stock based compensation	(1,916)	(684)
Net sales of investments - trading securities	6,927	7,880
Change in operating assets and liabilities:		
Accounts receivable	(2,236)	(4,003)
Other current assets	919	(864)
Accounts payable and accrued liabilities	(166)	(71)
Compensation and benefits payable	(8,683)	(5,931)
Income taxes payable and prepaid income taxes	(1,189)	(1,991)
Other liabilities	(29)	18
Net cash provided by operating activities	16,727	9,701
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(302)	(313)
Net cash used in investing activities	(302)	(313)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Purchase of treasury stock	(5,839)	(4,637)
Excess tax benefits from stock based compensation	1,916	684
Cash dividends	(7,291)	(2,988)
Net cash used in financing activities	(11,214)	(6,941)
Effect of currency rate changes on cash	(12)	(131)
NET INCREASE IN CASH AND CASH EQUIVALENTS	5,199	2,316
Cash and cash equivalents, beginning of period	10,864	3,817
Cash and cash equivalents, end of period	$16,063	$6,133
Supplemental cash flow information:		
Cash paid during the period for income taxes	$6,978	$5,723

See notes to condensed consolidated financial statements.

WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. DESCRIPTION OF THE BUSINESS

Westwood Holdings Group, Inc. (“Westwood”, the “Company”, “we”, “us” or “our”) was incorporated under the laws of the State of Delaware on December 12, 2001. Westwood manages investment assets and provides services for its clients through its subsidiaries, Westwood Management Corp. (“Westwood Management”), Westwood Trust (“Westwood Trust”), Westwood International Advisors Inc. (“Westwood International”) and Westwood Advisors, LLC. Westwood Management provides investment advisory services to corporate retirement plans, public retirement plans, endowments and foundations, mutual funds, individuals and clients of Westwood Trust. Westwood Trust provides institutions and high net worth individuals with trust and custodial services and participation in its sponsored common trust funds. Westwood International provides investment advisory services to corporate retirement plans, public retirement plans, endowments and foundations, mutual funds and other pooled investment vehicles. Westwood Advisors, LLC is an Omaha-based registered investment advisor. Revenue is largely dependent on the total value and composition of assets under management (“AUM”). Accordingly, fluctuations in financial markets and in the composition of AUM impact revenues and results of operations.

Westwood Management is a registered investment adviser under the Investment Advisers Act of 1940. Westwood Trust is chartered and regulated by the Texas Department of Banking. Westwood International is registered as a portfolio manager and exempt market dealer with the Ontario Securities Commission and the Autorité des marchés financiers (AMF) in Québec.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared without an audit and reflect all adjustments (consisting only of normal recurring adjustments) that, in the opinion of management, are necessary to present fairly our interim financial position and results of operations and cash flows for the periods presented. The accompanying condensed consolidated financial statements are presented using the accrual basis of accounting and have been prepared in accordance with the instructions for the presentation of interim financial information as prescribed by the Securities and Exchange Commission (“SEC”).

The accompanying condensed consolidated financial statements should be read in conjunction with our consolidated financial statements, and notes thereto, included in our Annual Report on Form 10-K for the year ended December 31, 2013. Operating results for the periods in these condensed consolidated financial statements are not necessarily indicative of the results for any future period. The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) and include the accounts of Westwood and its subsidiaries. All significant intercompany accounts and transactions have been eliminated upon consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. We believe the most significant estimates and assumptions are associated with the valuation of deferred taxes, stock-based compensation and impairment assessments of goodwill and intangible assets. Actual results could differ from those estimates.

Revenue Recognition

Investment advisory and trust fees are recognized as services are provided. These fees are determined in accordance with contracts between our subsidiaries and their clients and are generally based on a percentage of AUM. A limited number of our clients have contractual performance-based fee arrangements, which would pay us an additional fee if we outperform a specified index over a specific period of time. We record revenue for performance-based fees at the end of the measurement period. Most advisory and trust fees are payable in advance or in arrears on a calendar quarterly basis. Advance payments are deferred and recognized over the periods services are performed. Since billing periods for most of our advance paying clients coincide with the calendar quarter to which payment relates, revenue is recognized within the quarter. Consequently, no significant amount of deferred revenue is contained in our condensed consolidated financial statements. Deferred revenue is shown on the condensed consolidated balance sheets under the heading of “Accounts payable and accrued liabilities”. Other revenues generally consist of interest and investment income and are recognized as earned.

WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Principles of Consolidation

We assess each legal entity that we manage to determine whether consolidation is appropriate at the onset of the relationship. We first determine whether the entity is a voting interest entity (“VOE”) or a variable interest entity (“VIE”) under GAAP and then whether we have a controlling financial interest in the entity. Assessing whether an entity is a VOE or VIE and if it requires consolidation involves judgment and analysis. Factors considered in this assessment include, but are not limited to, the legal organization of the entity, our equity ownership and contractual involvement with the entity and any related party or de facto agent implications of our involvement with the entity. We reconsider whether an entity is a VOE or VIE whenever contractual arrangements change, the entity receives additional equity or returns equity to its investors or changes in facts and circumstances occur that change the ability of investors to direct the activities of the entity.

A VIE is an entity in which (i) the total equity investment at risk is not sufficient to enable the entity to finance its activities without subordinated financial support or (ii) the at-risk equity holders do not have the normal characteristics of a controlling financial interest. That is, the at-risk equity holders do not have the obligation to absorb losses, the right to receive residual returns and/or the right to direct the activities of the entity that most significantly impact the entity’s economic performance. An enterprise must consolidate all VIEs of which it is the primary beneficiary. We determine if a sponsored investment meets the definition of a VIE by considering whether the fund’s equity investment at risk is sufficient to finance its activities without additional subordinated financial support and whether the fund’s at-risk equity holders absorb any losses, have the right to receive residual returns and have the right to direct the activities of the entity most responsible for the entity’s economic performance. For VIEs that are investment companies, the primary beneficiary of the VIE is the party that absorbs a majority of the expected losses of the VIE, receives a majority of the expected residual returns of the VIE, or both. For VIEs that are not investment companies, the primary beneficiary of a VIE is defined as the party who, considering the involvement of related parties and de facto agents, has (i) the power to direct the activities of the VIE that most significantly affect its economic performance and (ii) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. This evaluation is updated continuously.

A VOE is an entity that is not within the scope of the guidance for VIEs. Consolidation of a VOE is required when a reporting entity owns a controlling financial interest in a VOE. Ownership of a majority of the voting interests is the usual condition for a controlling financial interest. At June 30, 2014 and December 31, 2013, none of our sponsored investment entities were VOEs subject to this assessment by the Company.

Westwood Investment Funds PLC (the “UCITS Fund”), which was authorized by the Central Bank of Ireland on June 18, 2013 pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (“UCITS”), is an Ireland domiciled umbrella-type open-ended self-managed investment company. The UCITS Fund is established as an umbrella fund with segregated assets and liabilities between sub-funds. Notwithstanding the segregation of assets and liabilities within each sub-fund, the UCITS Fund is a single legal entity and no sub-fund constitutes a legal entity separate from the UCITS Fund itself. Shares of the sub-fund, all of which are owned by the third-party investors, are listed on the Irish Stock Exchange. The base currency of the UCITS Fund is the pound sterling. We determined that the UCITS Fund was a VIE as its at-risk equity holders do not have the ability to direct the activities of the UCITS Fund that most significantly impact the entity’s economic performance. Although the Company does not have an equity investment in the UCITS Fund, in that the Company’s representatives have a majority control of the UCITS Fund's Board of Directors they can influence the UCITS Fund's management and affairs. The UCITS's Fund Board of Directors maintains this control through its duties which are stated in the UCITS Fund's Memorandum and Articles of Association which have no expiration date. We concluded that the Company was not the primary beneficiary of the UCITS Fund because even though it has the power to direct the activities of the UCITS Fund (that most significantly impact the fund's economic performance), it does not absorb a majority of the UCITS Fund's expected losses and does not receive a majority of the UCITS Fund's expected residual returns. As a result, the results of the UCITS Fund are not included in the Company's consolidated financial results.

We have also evaluated all of our other advisory relationships as well as our relationship as sponsor of our common trust funds to determine whether or not we qualify as the primary beneficiary based on whether there is an obligation to absorb the majority of expected losses or a right to receive the majority of residual returns. Since all losses and returns are distributed to the shareholders of the Westwood VIEs, we are not the primary beneficiary and consequently the Westwood VIEs are not included in our condensed consolidated financial statements. We have included the disclosures related to VIEs in Note 8.

Cash and Cash Equivalents

Cash and cash equivalents consist of short-term, highly liquid investments with maturities of three months or less, other than pooled investment vehicles considered to be investments. We maintain some cash and cash equivalents balances with financial institutions in excess of Federal Deposit Insurance Corporation insurance limits. The Company has not experienced losses on uninsured cash accounts.

Accounts Receivable

Accounts receivable represents balances arising from services provided to customers and are recorded on an accrual basis, net of any allowance for doubtful accounts. Accounts receivable are written off when they are determined to be uncollectible. Any allowance for doubtful accounts is estimated based on the Company’s historical write-off experience, existing conditions in the industry, and the financial stability of the customer. The majority of our accounts receivable balances consist of advisory and trust fees receivable from customers that we believe and have experienced to be fully collectible. Accordingly our condensed consolidated financial statements do not include an allowance for bad debt or any bad debt expense.

Investments

All marketable securities are classified as trading securities and are carried at quoted market value on the accompanying condensed consolidated balance sheets. Net unrealized holding gains or losses on investments classified as trading securities are reflected as a component of other revenues. We measure realized gains and losses on investments using the specific identification method. Investments include shares of Westwood mutual funds awarded to employees pursuant to mutual fund share incentive awards described in Note 9.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of acquired assets over the fair value of the underlying identifiable assets at the date of acquisition. Goodwill is not amortized but is tested for impairment at least annually.

We test more frequently if indicators are present or changes in circumstances suggest that impairment may exist. These indicators include, among others, declines in sales, earnings or cash flows, or the development of a material adverse change in the business climate. We assess goodwill for impairment at the reporting unit level, which is defined as an operating segment or one level below an operating segment, referred to as a component. We have identified two reporting units, which are consistent with our reporting segments: Advisory and Trust. The Company is not required to calculate the fair value of a reporting unit unless the Company determines that it is more likely than not that its fair value is less than the carrying amount. The Company assesses goodwill for impairment using a qualitative assessment that includes consideration of the current trends in the industry in which the Company operates, macroeconomic conditions, recent financial performance of the Company’s reporting units and a market multiple approach valuation. In performing the annual impairment test, which is performed during the third quarter or more frequently when impairment indicators exist and after assessing the qualitative factors, we may be required to utilize the two-step approach prescribed by ASC 350, Goodwill and Other Intangible Assets. The first step requires a comparison of each reporting unit’s carrying value to the fair value of the respective unit. If the carrying value exceeds the fair value, a second step is performed to measure the amount of impairment loss, if any. The fair value of each reporting unit is estimated, entirely or predominantly, using a market multiple approach. We completed our annual goodwill impairment assessment during the third quarter of 2013 and determined that no impairment loss was required. No impairments were recorded during any of the periods presented.

Our intangible assets represent the acquisition date fair value of acquired client relationships, trade names and non-compete agreements and are reflected net of amortization. In valuing these assets, we made significant estimates regarding their useful lives, growth rates and potential attrition. We periodically review intangible assets for events or circumstances that would indicate impairment. See Note 6.

Income Taxes

We file a United States federal income tax return as a consolidated group for Westwood and its subsidiaries based in the U.S. We also file a separate Canadian income tax return for Westwood International. Deferred income tax assets and liabilities are determined based on temporary differences between the financial statement and income tax bases of assets and liabilities as measured at enacted income tax rates. Deferred income tax expense generally reflects changes in deferred tax assets and liabilities. Deferred taxes relate primarily to stock-based compensation expense and net operating losses at Westwood International.

WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

We record net deferred tax assets when we believe such assets will more likely than not be realized. In making such a determination, we consider all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. If we were to determine that we would be able to realize our deferred income tax assets in the future in excess of the net recorded amount, we would make an adjustment to the deferred tax asset valuation allowance, which would reduce the provision for income taxes. No valuation allowance has been recorded in our condensed consolidated financial statements.

We recognize tax liabilities in accordance with ASC 740, Income Taxes, and we adjust them when our judgment reflects the evaluation of new information. Because of the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from our current estimate of the tax liabilities. These differences will be reflected as increases or decreases to income tax expense in the period in which new information becomes available. At June 30, 2014 and December 31, 2013, the Company had not established any reserves for, nor recorded any unrecognized tax benefits related to, uncertain tax positions.

Currency Translation

Assets and liabilities of Westwood International, our non-U.S. dollar functional currency subsidiary, are translated at exchange rates as of applicable reporting dates. Revenues and expenses are translated at average exchange rates during the periods indicated. The gains and losses resulting from translating non-U.S. dollar functional currency into U.S. dollars are recorded through other comprehensive income.

Long-term Compensation Agreements

We entered into employment agreements with certain employees of Westwood International that provide for specified payments over four years, the latest of which is in 2015. In certain circumstances, these payments would be forfeited to us if the employment of these individuals is terminated before completion of the contractual earning period. Payments made in advance under these agreements are included in “accounts payable and accrued liabilities” on our condensed consolidated balance sheets, net of amounts already amortized.

Stock Based Compensation

We account for stock-based compensation in accordance with Financial Accounting Standards Board Accounting Standards Codification No. 718, Compensation-Stock Compensation (“ASC 718”). Under ASC 718, stock-based compensation expense reflects the fair value of stock-based awards measured at grant date, is recognized over the relevant service period, and is adjusted each period for anticipated forfeitures.

We have issued restricted stock and granted stock options in accordance with our Third Amended and Restated Westwood Holdings Group, Inc. Stock Incentive Plan, as amended (the “Plan”). We apply judgment in developing an expectation of awards of restricted stock and stock options that may be forfeited. If actual experience differs significantly from these estimates, our stock-based compensation expense and results of operations could be materially affected.

We have compensation arrangements with certain employees of Westwood International pursuant to which these employees are able to earn cash awards based on the performance of certain investment products. A portion of such awards may be paid in shares of our stock that vest over a multi-year period. We accrue a liability for these awards over both the annual period in which we determine it is probable that the award will be earned and, for the portion to be settled in shares, over the following three-year vesting period. For the six months ended June 30, 2014 and 2013 the expense recorded for these awards was $330,000 and $152,000, respectively. Cash awards expected to be settled in shares are funded into a trust pursuant to an established Canadian employee benefit plan. Generally, the Canadian trust subsequently acquires Westwood common shares in market transactions and holds such shares until the shares are vested and distributed, or until forfeited. Shares held in the trust are shown on our condensed consolidated balance sheets as treasury shares. During the first quarter of 2014 and the second quarter of 2013, the trust purchased in the open market 11,476 and 20,251 Westwood common shares for approximately $670,000 and $880,000, respectively. Until shares are acquired by the trust, we measure the liability as a cash-based award included in "Compensation and benefits payable" on our condensed consolidated balance sheets. When the number of shares related to an award is determinable, the award becomes an equity award accounted for similarly to restricted stock, which is described in Note 9.

WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Recent Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. The ASU is intended to reduce the frequency of disposals reported as discontinued operations by focusing on strategic shifts that have (or will have) a major effect on an entity's operations and financial results. The standard will be effective for annual reporting periods beginning after December 15, 2014, although early adoption is permitted. We do not currently expect the adoption of this ASU to have a significant impact on our financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which was the result of a joint project by the FASB and International Accounting Standards Board to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards. The issuance of a comprehensive and converged standard on revenue recognition is expected to improve the ability of financial statement users to understand and consistently analyze an entity's revenue across industries, transactions, and geographies. The standard will require additional disclosures to help financial statement users better understand the nature, amount, timing, and potential uncertainty of the revenue being recognized. ASU 2014-09 will be effective for annual reporting periods beginning after December 15, 2016, and will require either retrospective application to each prior reporting period presented or retrospective application with the cumulative effect of initially applying the standard recognized at the date of adoption. We are currently evaluating the impact that the application of ASU 2014-09 will have on our financial statements and disclosures.

In June 2014, the FASB issued ASU 2014-12 Compensation—Stock Compensation (Topic 718) Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period, which establishes specific guidance on how to account for share-based payments for awards with performance targets after the employee completes the requisite service period. Current U.S. GAAP does not contain explicit guidance on how to account for those share-based payments. The standard will be effective for annual reporting periods beginning after December 15, 2015, although early adoption is permitted. We do not currently expect the adoption of this ASU to have a significant impact on our financial statements.

3. EARNINGS PER SHARE

Basic earnings per common share is computed by dividing net income available to common stockholders by the weighted average number of shares outstanding for the applicable period. Diluted earnings per share for these periods is computed based on the weighted average number of shares outstanding plus the effect of any dilutive shares of restricted stock and stock options granted to employees and non-employee directors. There were approximately 37,000 anti-dilutive restricted shares as of June 30, 2014. There were no anti-dilutive restricted shares or options as of June 30, 2013.

The following table sets forth the computation of basic and diluted shares (in thousands, except per share and share amounts):

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Net income	$8,822	$4,879	$14,581	$7,712
Weighted average shares outstanding - basic	7,523,347	7,349,868	7,499,016	7,318,688
Dilutive potential shares from unvested restricted shares	215,803	145,655	221,409	173,704
Weighted average shares outstanding - diluted	7,739,150	7,495,523	7,720,425	7,492,392
Earnings per share:				
Basic	$1.17	$0.66	$1.94	$1.05
Diluted	$1.14	$0.65	$1.89	$1.03

WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

4. INVESTMENTS

Investment balances are presented in the table below (in thousands). All investments are carried at fair value, and all investments are accounted for as trading securities.

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
June 30, 2014:				
U.S. Government and Government agency obligations	$50,905	$ 11	$ —	$ 50,916
Money market funds	1,219	—	—	1,219
Equity funds	2,405	160	(12)	2,553
Fixed income funds	3,058	26	—	3,084
Marketable securities	$57,587	$ 197	$ (12)	$ 57,772
December 31, 2013:				
U.S. Government and Government agency obligations	$42,595	$ 16	$ —	$ 42,611
Money market funds	8,584	—	—	8,584
Equity funds	2,130	200	(54)	2,276
Fixed income funds	10,984	99	—	11,083
Marketable securities	$64,293	$ 315	$ (54)	$ 64,554

5. FAIR VALUE MEASUREMENTS

We determine estimated fair values of our financial instruments using available information. The fair value amounts discussed in our condensed consolidated financial statements are not necessarily indicative of either amounts realizable upon disposition of these instruments or our intent or ability to dispose of these assets. The estimated fair value of cash and cash equivalents, accounts receivable, prepaid expenses, accounts payable, dividends payable, income taxes payable and accrued liabilities, approximates their carrying value due to their short-term maturities and are classified as level 1 fair value measurements. The carrying amount of investments designated as “trading” securities, primarily U.S. Government and Government agency obligations, money market funds, Westwood Funds® mutual funds and Westwood Trust common trust fund shares, equals their fair value based on prices quoted in active markets and, with respect to funds, the net asset value of the shares held as reported by the fund. Market values of our money market holdings generally do not fluctuate.

ASC 820, Fair Value Measurements and Disclosures, defines fair value, establishes a framework for measuring fair value and requires additional disclosures regarding certain fair value measurements. ASC 820 establishes a three-tier hierarchy for measuring fair value as follows:

- level 1 – quoted market prices in active markets for identical assets
- level 2 – inputs other than quoted prices that are directly or indirectly observable
- level 3 – unobservable inputs where there is little or no market activity

WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

The following table summarizes the values of our assets as of the dates indicated within the fair value hierarchy (in thousands).

	Level 1	Level 2	Level 3	Total
As of June 30, 2014:				
Investments in securities:				
Trading	$55,610	$2,162	$ —	$57,772
Total financial instruments	$55,610	$2,162	$ —	$57,772
As of December 31, 2013:				
Investments in securities:				
Trading	$64,554	$—	$ —	$64,554
Total financial instruments	$64,554	$—	$ —	$64,554

Investments categorized as level 2 assets consist of investments in common trust funds sponsored by Westwood Trust. Common trust funds are private investment vehicles comprised of commingled investments held in trusts that are valued using the Net Asset Value ("NAV"), calculated by us as administrator of the funds. The NAV is quoted on an inactive private market; however, the unit price is based on the market value of the underlying investments that are traded on an active market. Westwood Trust sponsors common trust funds for most of the investment strategies managed by Westwood Management. These strategies are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013. Investments in the funds are generally redeemable on a daily basis. There are no current plans to sell any of these investments.

6. INTANGIBLE ASSETS

The following is a summary of our intangible assets at June 30, 2014 and December 31, 2013 (in thousands):

	Weighted Average Amortization Period (years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
June 30, 2014:				
Client relationships	14.20	$ 5,005	$ (1,395)	$ 3,610
Total		$ 5,005	$ (1,395)	$ 3,610

December 31, 2013:				
Client relationships	14.20	$ 5,005	$ (1,216)	$ 3,789
Total		$ 5,005	$ (1,216)	$ 3,789

Amortization expense was $180,000 and $180,000 for the six months ended June 30, 2014 and 2013, respectively.

Estimated amortization expense for intangible assets for the next five years follows (in thousands):

For the Year ending December 31,	Estimated Amortization Expense
2014	$ 359
2015	359
2016	359
2017	359
2018	359

WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

7. BALANCE SHEET COMPONENTS

Accumulated Other Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss) were as follows (in thousands):

	As of June 30, 2014	As of December 31, 2013
Foreign currency translation adjustment	$(279)	$ (257)
Accumulated other comprehensive loss	$(279)	$ (257)

Accrued Dividends

Accrued dividends of $994,000 at June 30, 2014 and $1,266,000 at December 31, 2013 are dividends accrued on unvested restricted shares that are expected to vest subsequent to June 30, 2015. When those unvested restricted shares vest, the dividends accrued on those shares will be paid.

8. VARIABLE INTEREST ENTITIES

Westwood Trust sponsors common trust funds ("CTFs") for its clients. These funds allow clients to commingle assets to achieve economies of scale. Westwood International provides investment advisory services to the UCITS Fund. Westwood Management provides investment advisory services to the Westwood Funds®, a family of mutual funds, and to two collective investment trusts ("CITs"). Some clients of Westwood Management hold their investments in ten limited liability companies ("LLCs") that were formed and sponsored by McCarthy Group Advisors, L.L.C. The CTFs, Westwood Funds®, CITs and LLCs ("Westwood VIEs") are considered VIEs because our clients, who hold the equity at risk, do not have a direct or indirect ability through voting or similar rights to make decisions about the funds that would have a significant effect on their success. We receive fees for managing assets in these entities commensurate with market rates.

We evaluate all of our advisory relationships and CTFs to determine whether or not we qualify as the primary beneficiary based on whether there is an obligation to absorb the majority of expected losses or a right to receive the majority of expected residual returns. Since all losses and returns are distributed to the shareholders of the Company's VIEs, we are not the primary beneficiary and consequently the Westwood VIEs are not included in our condensed consolidated financial statements.

Otherwise, we have not provided any financial support not previously contractually obligated to provide and there are no arrangements that would require us to provide additional financial support to any of these VIEs. Our investments in the Westwood Funds® and the CTFs are accounted for as investments in accordance with our other investments described in Note 4.

The following table displays assets under management, corporate money invested and risk of loss in each vehicle (in millions).

	As of June 30, 2014		
	Assets Under Management	Corporate Investment	Risk of Loss
Westwood Funds®	$3,290	$ 3.5	$3.5
Common Trust Funds	2,737	2.1	2.1
Collective Investment Trusts	324	—	—
LLCs	262	—	—
UCITS Fund	839		