

WESTWOOD HOLDINGS GROUP INC
Form 10-Q
October 24, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2018
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 75201
DALLAS, TEXAS (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 No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any

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new or revised accounting standards provided
pursuant to Section 13(a) of the Exchange Act.

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

Yes No

Shares of common stock, par value \$0.01 per share, outstanding as of October 19, 2018: 9,018,436.

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)
(Unaudited)

| | September 30, 2018 | December 31, 2017 |
|--|-----------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 48,086 | \$54,249 |
| Accounts receivable | 19,832 | 21,660 |
| Investments, at fair value | 71,003 | 51,324 |
| Prepaid income taxes | 589 | 4,269 |
| Other current assets | 2,308 | 6,612 |
| Total current assets | 141,818 | 138,114 |
| Investments | 5,425 | — |
| Goodwill | 19,804 | 27,144 |
| Deferred income taxes | 5,081 | 3,407 |
| Intangible assets, net | 16,379 | 19,804 |
| Property and equipment, net of accumulated depreciation of \$6,287 and \$5,673 | 4,120 | 4,190 |
| Total assets | \$ 192,627 | \$192,659 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$ 2,521 | \$3,501 |
| Dividends payable | 7,295 | 7,357 |
| Compensation and benefits payable | 12,726 | 19,075 |
| Income taxes payable | 2,198 | 1,598 |
| Total current liabilities | 24,740 | 31,531 |
| Accrued dividends | 1,349 | 1,717 |
| Noncurrent income taxes payable | — | 1,017 |
| Deferred rent | 1,866 | 1,998 |
| Total liabilities | 27,955 | 36,263 |
| Commitments and contingencies (Note 13) | | |
| Stockholders' Equity: | | |
| Common stock, \$0.01 par value, authorized 25,000,000 shares, issued 10,196,635 and outstanding 9,018,436 shares at September 30, 2018; issued 9,980,827 and outstanding 8,899,587 shares at December 31, 2017 | 102 | 100 |
| Additional paid-in capital | 191,062 | 179,241 |
| Treasury stock, at cost - 1,178,199 shares at September 30, 2018; 1,081,240 shares at December 31, 2017 | (55,215 |) (49,788) |
| Accumulated other comprehensive loss | (2,826 |) (1,764) |
| Retained earnings | 31,549 | 28,607 |
| Total stockholders' equity | 164,672 | 156,396 |
| Total liabilities and stockholders' equity | \$ 192,627 | \$192,659 |

See Notes to Condensed Consolidated Financial Statements.

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 September 30, | | Nine Months Ended September 30, | |
|--|--|-----------|------------------------------------|-----------|
| | 2018 | 2017 | 2018 | 2017 |
| REVENUES: | | | | |
| Advisory fees: | | | | |
| Asset-based | \$22,023 | \$ 25,334 | \$69,979 | \$ 73,619 |
| Performance-based | — | — | 2,984 | 1,417 |
| Trust fees | 7,191 | 7,858 | 22,265 | 23,570 |
| Other, net | 640 | 300 | 953 | 1,265 |
| Total revenues | 29,854 | 33,492 | 96,181 | 99,871 |
| EXPENSES: | | | | |
| Employee compensation and benefits | 14,444 | 15,601 | 46,857 | 48,875 |
| Sales and marketing | 549 | 457 | 1,401 | 1,447 |
| Westwood mutual funds | 979 | 977 | 2,966 | 2,749 |
| Information technology | 2,332 | 1,855 | 6,753 | 5,494 |
| Professional services | 1,372 | 1,681 | 3,677 | 4,495 |
| Legal settlement | — | 4,009 | — | 4,009 |
| General and administrative | 3,027 | 3,160 | 6,477 | 8,697 |
| Total expenses | 22,703 | 27,740 | 68,131 | 75,766 |
| Net operating income | 7,151 | 5,752 | 28,050 | 24,105 |
| Gain on sale of operations | — | — | 524 | — |
| Income before income taxes | 7,151 | 5,752 | 28,574 | 24,105 |
| Provision for income taxes | 1,783 | 1,620 | 7,236 | 7,013 |
| Net income | \$5,368 | \$ 4,132 | \$21,338 | \$ 17,092 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustments | 616 | 1,297 | (1,062) | 2,438 |
| Total comprehensive income | \$5,984 | \$ 5,429 | \$20,276 | \$ 19,530 |
| Earnings per share: | | | | |
| Basic | \$0.64 | \$ 0.51 | \$2.55 | \$ 2.10 |
| Diluted | \$0.62 | \$ 0.49 | \$2.49 | \$ 2.05 |
| Weighted average shares outstanding: | | | | |
| Basic | 8,402,697 | 8,171,809 | 8,359,088 | 8,136,350 |
| Diluted | 8,598,230 | 8,420,749 | 8,561,918 | 8,350,926 |
| Cash dividends declared per share | \$0.68 | \$ 0.62 | \$2.04 | \$ 1.86 |

See Notes to Condensed Consolidated Financial Statements.

WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

For the Nine Months Ended September 30, 2018

(In thousands, except share amounts)

(Unaudited)

| | Common Stock, Par | | Additional Paid-In Capital | Treasury Stock | Accumulated Other Comprehensive Loss | Retained Earnings | Total |
|---|----------------------|--------|----------------------------------|-------------------|---|----------------------|-----------|
| | Shares | Amount | | | | | |
| BALANCE, December 31, 2017 | 8,899,587 | \$ 100 | \$179,241 | \$(49,788) | \$ (1,764) | \$28,607 | \$156,396 |
| Net income | — | — | — | — | — | 21,338 | 21,338 |
| Other comprehensive loss | — | — | — | — | (1,062) | — | (1,062) |
| Issuance of restricted stock, net of forfeitures | 215,808 | 2 | (2) | — | — | — | — |
| Dividends declared | — | — | — | — | — | (18,396) | (18,396) |
| Stock based compensation expense | — | — | 11,658 | — | — | — | 11,658 |
| Reclassification of compensation liability to be paid in shares | — | — | 165 | — | — | — | 165 |
| Purchases of treasury stock | (13,031) | — | — | (726) | — | — | (726) |
| Restricted stock returned for payment of taxes | (83,928) | — | — | (4,701) | — | — | (4,701) |
| BALANCE, September 30, 2018 | 9,018,436 | \$ 102 | \$191,062 | \$(55,215) | \$ (2,826) | \$31,549 | \$164,672 |

See Notes to Condensed Consolidated Financial Statements.

WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | Nine Months Ended September 30, | |
|---|---------------------------------------|-----------|
| | 2018 | 2017 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$21,338 | \$17,092 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 653 | 722 |
| Amortization of intangible assets | 1,255 | 1,449 |
| Unrealized (gains) losses on trading investments | 145 | (539) |
| Stock based compensation expense | 11,658 | 12,298 |
| Deferred income taxes | (1,693) | 1,481 |
| Gain on sale of operations | (524) | — |
| Change in operating assets and liabilities: | | |
| Net sales (purchases) of investments - trading securities | (19,824) | 8,931 |
| Accounts receivable | 1,537 | 1,686 |
| Other current assets | 4,185 | (3,881) |
| Accounts payable and accrued liabilities | (650) | 178 |
| Accrued litigation settlement | — | 8,018 |
| Compensation and benefits payable | (6,157) | (2,696) |
| Income taxes payable | 3,265 | (5,181) |
| Other liabilities | (118) | (111) |
| Net cash provided by operating activities | 15,070 | 39,447 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (676) | (537) |
| Proceeds from Omaha divestiture | 10,013 | — |
| Purchase of investments | (5,425) | — |
| Net cash provided by (used in) investing activities | 3,912 | (537) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Purchase of treasury stock under employee stock plans | (726) | (1,326) |
| Restricted stock returned for payment of taxes | (4,701) | (5,231) |
| Cash dividends paid | (18,825) | (16,787) |
| Net cash used in financing activities | (24,252) | (23,344) |
| Effect of currency rate changes on cash | (893) | 2,191 |
| Net Change in Cash and Cash Equivalents | (6,163) | 17,757 |
| Cash and cash equivalents, beginning of period | 54,249 | 33,679 |
| Cash and cash equivalents, end of period | \$48,086 | \$51,436 |
| Supplemental cash flow information: | | |
| Cash paid during the period for income taxes | \$5,634 | \$10,245 |
| Accrued dividends | \$8,644 | \$8,161 |

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 provides investment management services to institutional investors, private wealth clients and financial intermediaries through its subsidiaries, Westwood Management Corp. and Westwood Advisors, L.L.C. (together “Westwood Management”), Westwood Trust, and Westwood International Advisors Inc. (“Westwood International”). 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.

Divestiture of our Omaha Operations

On September 6, 2017, we entered into an agreement to sell the Omaha-based component of our Private Wealth business. The sale closed on January 12, 2018. We received proceeds of \$10.0 million, net of working capital requirements, and recorded a \$524,000 gain on the sale, which is included as “Gain on sale of operations” on our Consolidated Statements of Comprehensive Income. The sale reduced goodwill and intangible assets but did not have a material impact on our Condensed Consolidated Balance Sheet. The following table presents cash proceeds received and net assets sold (in thousands):

| | | | |
|--|------|--------|--|
| Cash Proceeds | \$ | 10,013 | |
| Net assets sold: | | | |
| Accounts receivable | | 99 | |
| Other current assets | | 112 | |
| Goodwill | | 7,340 | |
| Intangible assets, net | | 2,170 | |
| Property and equipment, net | | 18 | |
| Accounts payable and accrued liabilities | (241 |) | |
| Other liabilities | (9 |) | |
| Gain on sale of operations | \$ | 524 | |

The component is reported within both our Advisory and Trust segments. The sale did not represent a major strategic shift in our business and did not qualify for discontinued operations reporting.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying Condensed Consolidated Financial Statements are unaudited and are presented in accordance with the requirements for quarterly reports on Form 10-Q and consequently do not include all of the information and footnote disclosures required by accounting principles generally accepted in the United States of America (“GAAP”). The Company’s Condensed Consolidated Financial Statements reflect all adjustments (consisting only of normal recurring adjustments) necessary in the opinion of management 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 in accordance with GAAP and the rules and regulations of the Securities and Exchange Commission (“SEC”).

WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Unaudited)

The accompanying unaudited 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, 2017, filed with the SEC. Operating results for the periods in these Condensed Consolidated Financial Statements are not necessarily indicative of results for any future period. The accompanying Condensed Consolidated Financial Statements include the accounts of Westwood and its subsidiaries. All intercompany accounts and transactions have been eliminated upon consolidation.

Recent Accounting Pronouncements

Recently Adopted

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers (Topic 606), which resulted from a joint project by the FASB and the International Accounting Standards Board to clarify the principles for recognizing revenue and to develop a common revenue standard for GAAP and International Financial Reporting Standards (“IFRS”). The ASU is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Retrospective application is required, with the entity either applying the change to each prior reporting period presented or applying the cumulative effect of each prior reporting period presented at the date of initial application. We adopted ASU 2014-09 effective January 1, 2018. See further discussion in Note 9 “Revenue.” In March 2018, the FASB issued ASU 2018-05, Income Taxes: Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118, to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Cuts and Jobs Act (“Tax Reform Act”). See further discussion in Note 11 “Income Taxes.”

Not Yet Adopted

In February 2016, the FASB issued ASU 2016-02, Leases. ASU 2016-02 requires lessees to recognize a lease liability and a right-of-use asset for all leases at the commencement date, excluding short-term leases. Leases will be classified as either financing or operating, with classification impacting the pattern of expense recognition in the income statement. The amendment is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. We will adopt the standard as of January 1, 2019 under the modified retrospective approach, which allows for recording the cumulative effect of the adoption of the standard as an adjustment to beginning retained earnings. We will elect the package of practical expedients permitted under the transition guidance, which among other things, allows us to carry forward the historical lease classification and elect hindsight to determine certain lease terms for existing leases. We have evaluated our population of contracts subject to balance sheet recognition and estimate adoption will result in recognition of additional lease assets and net lease liabilities of approximately \$8 million as of January 1, 2019 primarily related to the future minimum payments required under operating leases as disclosed in Note 13 “Commitments and Contingencies” to our Consolidated Financial Statements included in our Annual Report Form 10-K for the fiscal year ended December 31, 2017. The insignificant difference in the additional lease assets and net lease liabilities will be recorded as an adjustment to beginning retained earnings. We do not believe the standard will materially impact our Consolidated Statements of Comprehensive Income or Consolidated Statements of Cash Flows. Beginning with our Quarterly Report on Form 10-Q for the quarter ended March 31, 2019, we will add disclosures surrounding our leases, including lease cost disaggregation, weighted average remaining lease terms and weighted average discount rate used to determine our lease assets and liabilities. We have also analyzed our current business process and internal controls and anticipate implementing new procedures to successfully adopt the standard, particularly for identification of leases and evaluation of the discount rate. In June 2018, the FASB issued ASU 2018-07, Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. The purpose of this amendment is to simplify the accounting for share-based payments granted to nonemployees for goods and services by aligning it with the accounting used for arrangements with employees. The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. We do not expect the

amendment to have a material impact on our Consolidated Financial Statements, and we plan to adopt the standard within the required time frame.

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WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework- Changes to the Disclosure Requirements for Fair Value Measurement. The purpose of this amendment is to modify, remove and add certain disclosure requirements for fair value measurements. Under ASU 2018-13, entities are required to disclose the amount of total gains or losses recognized in other comprehensive income attributable to assets and liabilities categorized within Level 3 of the fair value hierarchy. The ASU also adds an incremental requirement about significant unobservable inputs for Level 3 fair value measurements. The requirement to disclose reasons for transfers between Level 1 and Level 2 was removed. Various requirements for Level 3 disclosure were also modified. The amendments in this ASU are effective for all entities for fiscal years and interim periods beginning after December 15, 2019. We do not expect the amendment to have a material impact on our Consolidated Financial Statements, and we plan to adopt this amendment within the required time frame.

In August 2018, the FASB issued ASU 2018-15, Intangibles- Goodwill and Other - Internal-Use Software (Topic 350): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. The purpose of this amendment is to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The amendments in this update are effective for public companies for fiscal years beginning after December 15, 2019, including interim periods within that fiscal year. We do not expect the amendment to have a material impact on our Consolidated Financial Statements, and we plan to adopt the standard within the required time frame.

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 is computed based on the weighted average number of shares outstanding plus the effect of any dilutive shares of restricted stock granted to employees and non-employee directors. There were no anti-dilutive restricted shares outstanding for the three months ended September 30, 2018 and 2017. There were approximately 3,251 and 8,800 anti-dilutive restricted shares outstanding for the nine months ended September 30, 2018 and 2017, respectively.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|--|-----------|---------------------------------------|-----------|
| | 2018 | 2017 | 2018 | 2017 |
| Net income | \$5,368 | \$ 4,132 | \$21,338 | \$ 17,092 |
| Weighted average shares outstanding - basic | 8,402,698 | 7,171,809 | 8,359,088 | 8,136,350 |
| Dilutive potential shares from unvested restricted shares | 195,533 | 248,940 | 202,830 | 214,576 |
| Weighted average shares outstanding - diluted | 8,598,231 | 7,420,749 | 8,561,918 | 8,350,926 |