

GWG Holdings, Inc.
Form 10-Q
August 08, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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 June 30, 2014
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
(State or other jurisdiction of
incorporation or organization)

26-2222607
(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. T Yes F 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 F 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 (as defined in Rule 12b-2 of the Exchange Act).

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Large accelerated filer
Non-accelerated filer

Accelerated filer
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

As of August 8, 2014, GWG Holdings, Inc. had 4,562,000 shares of common stock outstanding.

GWG HOLDINGS, INC.

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for the Quarter Ended June 30, 2014

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GWG HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2014 (unaudited)	December 31, 2013
A S S E T S		
Cash and cash equivalents	\$ 23,059,955	\$ 33,449,793
Restricted cash	2,810,432	5,832,970
Investment in life settlements, at fair value	267,895,692	234,672,794
Other assets	2,822,074	1,424,919
TOTAL ASSETS	\$ 296,588,153	\$ 275,380,476
LIABILITIES & STOCKHOLDERS' EQUITY (DEFICIT)		
LIABILITIES		
Revolving credit facility	\$ 79,000,000	\$ 79,000,000
Series I Secured notes payable	28,051,113	29,275,202
Renewable Secured Debentures	157,513,267	131,646,062
Interest payable	9,730,193	7,209,408
Accounts payable and accrued expenses	1,714,418	1,343,952
Deferred taxes, net	5,403,604	7,675,174
TOTAL LIABILITIES	281,412,595	256,149,798
CONVERTIBLE, REDEEMABLE PREFERRED STOCK		
(par value \$0.001; shares authorized 40,000,000; shares issued and outstanding 3,419,767 and 3,368,109; liquidation preference of \$25,648,000 and \$25,261,000 on June 30, 2014 and December 31, 2013, respectively)	25,309,946	24,722,693
STOCKHOLDERS' EQUITY		
Common stock (par value \$0.001; shares authorized 210,000,000; shares issued and outstanding is 4,562,000 on both June 30, 2014 and December 31, 2013)	4,562	4,562
Additional paid-in capital	2,787,494	2,942,000
Accumulated deficit	(12,926,444)	(8,438,577)
TOTAL STOCKHOLDERS' EQUITY (DEFICIT)	(10,134,388)	(5,492,015)
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY (DEFICIT)	\$ 296,588,153	\$ 275,380,476

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

GWG HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
REVENUE				
Gain on life settlements, net	\$5,484,889	\$7,733,245	\$11,001,094	\$16,073,601
Interest and other income	6,380	3,274,323	13,747	3,441,994
TOTAL REVENUE	5,491,269	11,007,568	11,014,841	19,515,595
EXPENSES				
Employee compensation and benefits	1,178,819	1,063,923	2,147,564	3,001,343
Legal and professional fees	419,337	351,910	826,339	789,200
Interest expense	6,608,043	4,941,942	12,934,591	9,409,157
Other expenses	1,188,479	1,091,132	1,865,784	2,124,277
TOTAL EXPENSES	9,394,678	7,448,907	17,774,278	15,323,977
INCOME (LOSS) BEFORE INCOME TAXES	(3,903,409)	3,558,661	(6,759,437)	4,191,618
INCOME TAX EXPENSE (BENEFIT)	(1,316,712)	1,801,971	(2,271,570)	2,367,794
NET INCOME (LOSS)	\$(2,586,697)	\$1,756,690	\$(4,487,867)	\$1,823,824
Accretion of preferred stock to liquidation value	(101,271)	(208,877)	(226,984)	(466,640)
LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS	\$(2,687,968)	\$1,547,813	\$(4,714,851)	\$1,357,184
NET INCOME (LOSS) PER SHARE				
Basic	\$(0.59)	\$0.31	\$(1.03)	\$0.28
Diluted	\$(0.59)	\$0.21	\$(1.03)	\$0.19
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	4,562,000	4,984,994	4,562,000	4,774,102
Diluted	4,562,000	7,511,099	4,562,000	7,290,253

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

GWG HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income (loss)	\$(2,586,697)	\$1,756,690	\$(4,487,867)	\$1,823,824
Adjustments to reconcile net income (loss) to net cash flows from operating activities:				
Gain on life settlements	(10,852,425)	(7,449,180)	(22,211,338)	(18,943,905)
Amortization of deferred financing and issuance costs	1,354,007	837,133	1,707,664	1,930,880
Deferred income taxes	(1,316,712)	1,802,920	(2,271,570)	2,366,794
Convertible, redeemable preferred stock dividends payable	196,991	178,235	389,331	261,937
(Increase) decrease in operating assets:				
Other assets	(997,073)	(4,164,004)	(1,248,919)	(3,614,132)
Increase (decrease) in operating liabilities:				
Accounts payable and accrued expenses	1,890,337	402,739	3,168,163	1,694,797
NET CASH FLOWS USED IN OPERATING ACTIVITIES	(12,311,572)	(6,635,467)	(24,954,536)	(14,479,805)
CASH FLOWS FROM INVESTING ACTIVITIES				
Investment in life settlements	(2,608,232)	(2,972,944)	(10,879,435)	(12,885,993)
Proceeds from settlement of life settlements	68,500	1,382,152	68,500	2,872,152
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(2,539,732)	(1,590,792)	(10,810,935)	(10,013,841)
CASH FLOWS FROM FINANCING ACTIVITIES				
Net proceeds from revolving credit facility	-	-	-	8,000,000
Payments for redemption of Series I Secured notes payable	(670,621)	(2,423,052)	(1,538,924)	(3,930,876)
Proceeds from issuance of renewable secured debentures	14,868,830	18,588,867	33,234,487	42,439,661
Payments for redemption and issuance of renewable secured debentures	(4,393,523)	(3,033,303)	(9,322,411)	(5,336,571)
Proceeds from restricted cash	43,330	2,160,333	3,022,537	(2,370,775)
Repurchase of common stock	-	(3,252,400)	-	(3,252,400)
Issuance (redemptions) of convertible, redeemable preferred stock	(20,056)	(125,135)	(20,056)	(311,804)
NET CASH FLOWS PROVIDED BY FINANCING ACTIVITIES	9,827,960	11,915,310	25,375,633	35,237,235
NET INCREASE IN CASH AND CASH EQUIVALENTS	(5,023,344)	3,689,051	(10,389,838)	10,743,589

CASH AND CASH EQUIVALENTS

BEGINNING OF PERIOD	28,083,299	34,551,582	33,449,793	27,497,044
END OF PERIOD	\$23,059,955	\$38,240,633	\$23,059,955	\$38,240,633

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

GWG HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS – CONTINUED
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION				
Interest paid	\$3,531,000	\$3,214,000	\$7,781,000	\$6,512,000
NON-CASH INVESTING AND FINANCING ACTIVITIES				
Series I secured notes:				
Non-cash conversion of accrued interest and commissions payable to principal	\$40,000	\$86,000	\$105,000	\$150,000
Renewable secured debentures:				
Non-cash conversion of accrued interest and commission payable to principal	\$162,000	\$59,000	\$282,000	\$100,000
Convertible, redeemable preferred stock				
Non-cash conversion of dividends payable	\$193,000	\$178,000	\$380,000	\$262,000
Non-cash accretion of convertible, redeemable preferred stock to redemption value	\$101,000	\$209,000	\$227,000	\$467,000
Investment in life settlements included in accounts payable	\$75,000	\$262,000	\$75,000	\$262,000

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

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

	Common Shares	Common Stock (par)	Additional Paid-in Capital	Accumulated Deficit	Total Equity
Balance, December 31, 2012	4,994,500	4,995	6,976,838	(8,243,622)	(1,261,789)
Net loss	-	-	-	(194,955)	(194,955)
Repurchase of common stock	(432,500)	(433)	(3,251,967)	-	(3,252,400)
Issuance of stock options	-	-	23,753	-	23,753
Accretion of preferred stock to liquidation value	-	-	(806,624)	-	(806,624)
Balance, December 31, 2013	4,562,000	\$ 4,562	\$ 2,942,000	\$ (8,438,577)	\$ (5,492,015)
Net loss	-	-	-	(4,487,867)	(4,487,867)
Issuance of stock options	-	-	72,478	-	72,478
Accretion of preferred stock to liquidation value	-	-	(226,984)	-	(226,984)
Balance, June 30, 2014	4,562,000	4,562	2,787,494	(12,926,444)	(10,134,388)

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

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 - GWG Holdings, Inc. and subsidiaries, located in Minneapolis, Minnesota, facilitates the purchase of life insurance policies for its own investment portfolio through its wholly owned subsidiary, GWG Life, LLC (GWG Life), and its subsidiaries, GWG Trust (Trust), GWG DLP Funding II, LLC (DLP II) and its wholly owned subsidiary, GWG DLP Master Trust II (the Trust II). Our wholly owned subsidiary, GWG Broker Services, LLC (Broker Services), was formed to earn fees for brokering policy transactions between market participants. Our wholly owned subsidiary United Lending, LLC (United Lending) and its wholly owned subsidiary United Lending SPV, LLC (United Lending SPV) were formed to finance life settlement premiums and policy loans. All of these entities are legally organized in Delaware. Unless the context otherwise requires or we specifically so indicate, all references in this report to "we", "us", "our", "our Company", "GWG", or the "Company" refer to these entities collectively. GWG Member, LLC, a wholly owned subsidiary formed November 2010 to facilitate the acquisition of policies, has not commenced operations as of June 30, 2014.

Basis of presentation - The condensed consolidated balance sheet as of June 30, 2014, the condensed consolidated statements of operations for the three and six months ended June 30, 2014 and 2013, and the condensed consolidated statements of cash flows for the three and six months ended June 30, 2014 and 2013, and the related information presented in these notes, have been prepared by management in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X, without audit. To the extent that information and notes required by U.S. generally accepted accounting principles for complete financial statements are contained in or are consistent with the consolidated audited financial statements in the Company's Form 10-K for the year ended December 31, 2013, such information and notes have not been duplicated herein. In the opinion of management, all adjustments considered necessary for a fair presentation of results have been included. The condensed consolidated balance sheet at December 31, 2013 was derived from the audited consolidated financial statements as of that date. Operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. For further information, refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

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 and 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. The Company regularly evaluates estimates and assumptions. The Company bases its estimates and assumptions on current facts, historical experience, and various other factors that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the accrual of costs and expenses that are not readily apparent from other sources. The actual results experienced by the Company may differ materially and adversely from the Company's estimates. To the extent there are material differences between the estimates and the actual results, future results of operations will be affected. The most significant estimates with regard to these consolidated financial statements relates to (1) the determination of the assumptions used in estimating the fair value of the investment in life insurance policies, and (2) the value of deferred tax assets and liabilities.

Life settlements - ASC 325-30, Investments in Insurance Contracts, allows a reporting entity the election to account for its investments in life settlements using either the investment method or the fair value method. The election shall be made on an instrument-by-instrument basis and is irrevocable. Under the investment method, an investor shall

recognize the initial investment at the purchase price plus all initial direct costs. Continuing costs (policy premiums and direct external costs, if any) to keep the policy in force shall be capitalized. Under the fair value method, an investor shall recognize the initial investment at the purchase price. In subsequent periods, the investor shall remeasure the investment at fair value in its entirety at each reporting period and shall recognize the change in fair value in current period income net of premiums paid. The Company uses the fair value method to account for all life settlements.

The Company recognizes realized gains (revenue) from life settlement contracts upon one of the two following events:

- 1) Receipt of death notice or verified obituary of insured
- 2) Sale of policy and filing of change of ownership forms and receipt of payment

The Company recognizes the difference between the death benefits and carrying values of the policy when an insured event has occurred and the Company determines that settlement and ultimate collection of the death benefits is realizable and reasonably assured. Revenue from a transaction must meet both criteria in order to be recognized. In an event of a sale of a policy the Company recognizes gain or loss as the difference between the sale price and the carrying value of the policy on the date of the receipt of payment on such sale.

GWG HOLDINGS, INC. AND SUBSIDIARIES