GWG Holdings, Inc.
Form 10-Q
August 13, 2015

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, 2015

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. 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). Yes 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).

Large accelerated filer	Accelerated filer
Non-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 13, 2015, GWG Holdings, Inc. had 5,933,041 shares of common stock outstanding.

GWG HOLDINGS, INC.

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for the Quarter Ended June 30, 2015

PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GWG HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2015 (unaudited)	December 31, 2014
ASSETS		
Cash and cash equivalents	$38,198,189	$30,662,704
Restricted cash	7,923,190	4,296,053
Policy benefits receivable	2,500,000	1,750,000
Investment in life settlements, at fair value	301,498,527	282,883,010
Other assets	6,623,561	3,478,762
TOTAL ASSETS	$356,743,467	$323,070,529
LIABILITIES & STOCKHOLDERS' EQUITY (DEFICIT)		
LIABILITIES		
Revolving credit facility	$65,011,048	$72,161,048
Series I Secured notes	24,347,531	27,616,578
L Bonds	223,118,514	182,782,884
Interest payable	11,593,220	11,128,519
Accounts payable and accrued expenses	2,071,879	1,718,009
Deferred taxes, net	6,525,336	5,273,555
TOTAL LIABILITIES	332,667,528	300,680,593
STOCKHOLDERS' EQUITY		
CONVERTIBLE PREFERRED STOCK		
(par value $0.001; shares authorized 40,000,000; shares outstanding 2,746,412 and 2,738,966; liquidation preference of $20,598,000 and $20,542,000, respectively)	20,559,823	20,527,866
COMMON STOCK		
Common stock (par value $0.001: shares authorized 210,000,000; shares issued and outstanding is 5,933,041 and 5,870,193 on June 30, 2015 and December 31, 2014, respectively)	5,933	5,870
Additional paid-in capital	16,900,193	16,257,686
Accumulated deficit	(13,390,010)	(14,401,486)
TOTAL STOCKHOLDERS' EQUITY (DEFICIT)	24,075,939	22,389,936

TOTAL LIABILITIES & EQUITY (DEFICIT)	$356,743,467	$323,070,529

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		Six Months Ended	
	June 30, 2015	**June 30, 2014**	**June 30, 2015**	**June 30, 2014**
REVENUE				
Gain on life settlements, net	$8,473,886	$5,484,889	$25,257,295	$11,001,094
Interest and other income	90,380	6,380	139,676	13,747
TOTAL REVENUE	8,564,266	5,491,269	25,396,971	11,014,841
EXPENSES				
Employee compensation and benefits	2,144,725	1,178,819	3,872,642	2,147,564
Legal and professional fees	642,931	419,337	1,166,184	826,339
Interest expense	7,322,347	6,608,043	14,498,881	12,934,591
Other expenses	1,881,321	1,188,479	3,415,060	1,865,784
TOTAL EXPENSES	11,991,324	9,394,678	22,952,767	17,774,278
INCOME (LOSS) BEFORE INCOME TAXES	(3,427,058)	(3,903,409)	2,444,204	(6,759,437)
INCOME TAX EXPENSE (BENEFIT)	(1,176,643)	(1,316,712)	1,432,728	(2,271,570)
NET INCOME (LOSS)	$(2,250,415)	$(2,586,697)	$1,011,476	$(4,487,867)
(Income) loss attributable to preferred shareholders	344,847	(101,271)	698,003	(226,984)
INCOME (LOSS) ATTRIBUTABLE TO COMMON SHAREHOLDERS	$(1,905,568)	$(2,687,968)	$1,709,479	$(4,714,851)
NET INCOME (LOSS) PER SHARE				
Basic	$(0.32)	$(0.59)	$0.29	$(1.03)
Diluted	$(0.32)	$(0.59)	$0.21	$(1.03)
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	5,876,618	4,562,000	5,873,423	4,562,000
Diluted	5,876,618	4,562,000	7,987,923	4,562,000

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 June 30, 2015	Three Months Ended June 30, 2014	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income (loss)	$(2,250,415)	$(2,586,697)	$1,011,476	$(4,487,867)
Adjustments to reconcile net income (loss) to net cash flows from operating activities:				
Gain on life settlements	(14,028,327)	(10,852,425)	(12,134,482)	(22,211,338)
Amortization of deferred financing and issuance costs	507,026	1,354,007	(42,004)	1,707,664
Deferred income taxes	(930,470)	(1,316,712)	1,251,781	(2,271,570)
Convertible, redeemable preferred stock dividends payable	146,420	196,991	335,232	389,331
(Increase) decrease in operating assets:				
Policy benefits receivable	17,140,000	(300,000)	(750,000)	(300,000)
Other assets	(225,376)	(697,073)	(356,549)	(948,919)
Increase (decrease) in operating liabilities:				
Accounts payable and accrued expenses	(1,333,241)	1,890,337	1,302,446	3,168,163
NET CASH FLOWS USED IN OPERATING ACTIVITIES	(974,383)	(12,311,572)	(9,382,100)	(24,954,536)
CASH FLOWS FROM INVESTING ACTIVITIES				
Investment in life settlements	(7,777,541)	(2,608,232)	(10,224,018)	(10,879,435)
Proceeds from settlement of life settlements	132,388	68,500	3,742,983	68,500
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(7,645,153)	(2,539,732)	(6,481,035)	(10,810,935)
CASH FLOWS FROM FINANCING ACTIVITIES				
Repayment of revolving credit facility	(7,150,000)	-	(7,150,000)	-
Payments for redemption of Series I Secured notes	(2,344,355)	(670,621)	(3,617,544)	(1,538,924)
Proceeds from issuance of L Bonds	22,538,059	14,868,830	50,498,356	33,234,487
Payments for redemption and issuance of L Bonds	(6,134,935)	(4,393,523)	(13,013,057)	(9,322,411)
Proceeds from restricted cash	3,410,427	43,330	(3,627,137)	3,022,537
Issuance of common stock	582,000	-	582,000	-
Redemptions of convertible, redeemable preferred stock	(273,998)	(20,056)	(273,998)	(20,056)
NET CASH FLOWS PROVIDED BY FINANCING ACTIVITIES	10,627,198	9,827,960	23,398,620	25,375,633

NET INCREASE IN CASH AND CASH EQUIVALENTS	2,007,662	(5,023,344)	7,535,485	(10,389,838)
CASH AND CASH EQUIVALENTS				
BEGINNING OF PERIOD	36,190,527	28,083,299	30,662,704	33,449,793
END OF PERIOD	$38,198,189	$23,059,955	$38,198,189	$23,059,955

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, 2015	June 30, 2014	June 30, 2015	June 30, 2014
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION				
Interest paid	$7,041,000	$3,531,000	$13,143,000	$7,781,000
NON-CASH INVESTING AND FINANCING ACTIVITIES				
Series I Secured notes:				
Non-cash conversion of accrued interest and commissions payable to principal	$86,000	$40,000	$127,000	$105,000
L Bonds:				
Non-cash conversion of accrued interest and commission payable to principal	$219,000	$162,000	$438,000	$282,000
Convertible, redeemable preferred stock				
Non-cash conversion of dividends payable	$150,000	$193,000	$334,000	$380,000
Non-cash accretion of convertible, redeemable preferred stock to redemption value	$-	$101,000	$-	$227,000
Investment in life settlements included in accounts payable	$61,000	$75,000	$61,000	$75,000

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

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GWG HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Preferred Stock Shares	Preferred Stock	Common Shares	Common Stock (par)	Additional Paid-in Capital	Accumulated Deficit	Total Equity
Balance, December 31, 2013	**-**	**$-**	**4,562,000**	**$ 4,562**	**$2,942,000**	**$(8,438,577)**	**$(5,492,015)**
Net income	-	-	-	-	-	(5,962,909)	(5,962,909)
Issuance of common stock	-	-	800,000	800	8,642,990	-	8,643,790
Series A Preferred Stock conversion	-	-	508,193	508	4,956,591	-	4,957,099
Reclassification of preferred stock from temporary equity to permanent equity due to initial public offering (*)	2,710,214	20,326,605	-	-	-	-	20,326,605
Issuance of preferred stock	28,752	201,261	-	-	-	-	201,261
Issuance of stock options	-	-	-	-	122,412	-	122,412
Extension of warrants	-	-	-	-	47,120	-	47,120
Accretion of preferred stock to liquidation value	-	-	-	-	(453,427)	-	(453,427)
Balance, December 31, 2014	**2,738,966**	**$20,527,866**	**5,870,193**	**$ 5,870**	**$16,257,686**	**$(14,401,486)**	**$22,389,936**
Net income	-	-	-	-	-	1,011,476	1,011,476
Issuance of common stock	-	-	60,000	60	581,940	-	582,000

Series A Preferred Stock conversion to common stock	(3,797)	(28,478)	2,848	3	28,475	-	-
Issuance of preferred stock	11,243	60,435	-	-	-	-	60,435
Issuance of stock options	-	-	-	-	32,092	-	32,092
Balance, June 30, 2015	**2,746,412**	**$20,559,823**	**5,933,041**	**$ 5,933**	**$16,900,193**	**$(13,390,010)**	**$24,075,939**

* Subject to the terms of the Certificate of Designation for Series A Convertible Preferred Stock, the listing of our common stock on The Nasdaq Capital Market on September 25, 2014 resulted in the termination of a redemption right in favor of the holders of such preferred stock. Preferred stock that is not redeemable by a shareholder is treated as stockholders' equity as shown in the table above.

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 - GWG Holdings, Inc. (GWG Holdings) and subsidiaries, located in Minneapolis, Minnesota, facilitates the purchase of life insurance policies for its own investment portfolio through its wholly owned subsidiaries, GWG Life, LLC (GWG Life), and GWG Life USA, LLC (GWG Life USA), and GWG Life's own subsidiaries, GWG Trust (Trust), GWG DLP Funding II, LLC (DLP II) and its wholly owned subsidiary, GWG DLP Master Trust II (the Trust II), and GWG DLP Funding III, LLC (DLP III). 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. References to particular entities, such as "GWG Holdings" or "GWG Life", are meant to refer only to the particular entity referenced.

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.

Cash and cash equivalents - The Company considers cash in demand deposit accounts and temporary investments purchased with an original maturity of three months or less to be cash equivalents. The Company maintains its cash and cash equivalents with highly rated financial institutions. From time to time, the Company's balances in its bank accounts exceed Federal Deposit Insurance Corporation limits. The Company periodically evaluates the risk of exceeding insured levels and may transfer funds as it deems appropriate. The Company has not experienced any losses with regards to balances in excess of insured limits or as a result of other concentrations of credit risk.

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 re-measure 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.

Deposits and initial direct costs advanced on unsettled policy acquisitions are recorded as other assets until policy ownership has been transferred to the Company. Such deposits and direct cost advances were $222,000 and $27,000 at June 30, 2015 and December 31, 2014, respectively.

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Deferred financing and issuance costs – Costs incurred to obtain financing under the revolving credit facility, as described in note 5, have been capitalized and are amortized using the straight-line method over the term of the revolving credit facility. Amortization of deferred financing costs was $300,000 and $89,000 for the three-month periods ended June 30, 2015 and 2014, and $300,000 and $179,000 for the six-month periods ended June 30, 2015 and 2014, respectively. The future amortization is expected to be $1,500,000 for the next ten months ending April 30, 2016. The Series I Secured notes, as described in note 6, are reported net of issuance costs, sales commissions and other direct expenses, which are amortized using the interest method over the term of each respective borrowing. The L Bonds, as described in note 7, are reported net of issuance costs, sales commissions and other direct expenses, which are amortized using the interest method over the term of each respective borrowing. The Series A preferred stock, as described in note 8, was also reported net of issuance costs, sales commissions, including the fair value of warrants issued, and other direct expenses, which were amortized using the interest method as interest expense over the three-year redemption period. As of December 31, 2014 those costs were fully amortized.

Earnings (loss) per share - Basic per share earnings (loss) attributable to non-redeemable interests is calculated using the weighted-average number of shares outstanding during the period. Diluted earnings per share is calculated based on the potential dilutive impact, if any, of the Company's convertible, redeemable preferred stock, and outstanding warrants, and stock options.

Subsequent events - Subsequent events are events or transactions that occur after the balance sheet date but before consolidated financial statements are issued. The Company recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the consolidated financial statements. The Company's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before the consolidated financial statements are available to be issued. The Company evaluates subsequent events and transactions that occur after the balance sheet date up to the date that the consolidated financial statements are filed for potential recognition or disclosure.

Recently adopted pronouncements - On April 7, 2015 the FASB issued Accounting Standards Update (ASU) No. 2015-03, "Simplifying the Presentation of Debt Issuance Costs," as part of its simplification initiative. The ASU changes the presentation of debt issuance costs in financial statements. Under the ASU, an entity presents such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs is reported as interest expense. For public business entities, the guidance in the ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. For entities other than public business entities, the guidance is effective for fiscal years beginning after December 15, 2015, and interim periods beginning after December 15, 2016. Early adoption is allowed for all entities for financial statements that have not been previously issued. Entities would apply the new guidance retrospectively to all prior periods (i.e., the balance sheet for each period is adjusted). The impact of the new ASU on the Company's balance sheet would be a reduction of approximately $3,629,000 to assets and the corresponding reduction to liabilities. There would be no impact on the Company's statements of operations.

(2) Restrictions on cash

The Company is required by its lenders to maintain collection and escrow accounts. These accounts are used to fund the acquisition, pay annual premiums of insurance policies, pay interest and other charges under the revolving credit facility, and collect policy benefits. DZ Bank AG, as agent for Autobahn Funding Company, LLC, the lender for the revolving credit facility as described in note 5, authorizes the disbursements from these accounts. At June 30, 2015 and December 31, 2014 there was a balance of $7,923,000, and $4,296,000, respectively, maintained in these restricted cash accounts.

(3) Investment in life insurance policies

The life insurance policies (Level 3 fair value measurements) are valued based on unobservable inputs that are significant to the overall fair value measurement. Changes in the fair value of these instruments are recorded in gain or loss on life insurance policies in the consolidated statements of operations (net of the cash premiums paid on the policies). The fair value is determined on a discounted cash flow basis that incorporates life expectancy assumptions. Life expectancy reports have been obtained from widely accepted life expectancy providers. The discount rate incorporates current information about market interest rates, the credit exposure to the insurance company that issued the life insurance policy and our estimate of the risk premium an investor in the policy would require. As a result of management's analysis, discount rates of 11.19% and 11.43% were applied to the portfolio as of June 30, 2015 and December 31, 2014.

A summary of the Company's life insurance policies accounted for under the fair value method and their estimated maturity dates, based on remaining life expectancy is as follows:

	As of June 30, 2015			As of December 31, 2014		
Years Ending December 31,	Number of Contracts	Estimated Fair Value	Face Value	Number of Contracts	Estimated Fair Value	Face Value
2015	-	$ -	$ -	3	$	