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

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 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 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 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 x 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	x
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 ¨

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 x

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

WESTWOOD HOLDINGS GROUP, INC.
INDEX

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.

1

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 Shares	Common Stock, Par Amount	Additional Paid-In Capital	Treasury Stock	Accumulated Other Comprehensive Loss	Retained Earnings	Total
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.

3

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.

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	8,402,697	8,171,809	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	8,598,230	8,420,749	8,561,918	8,350,926
Earnings per share:				
Basic	$0.64	$ 0.51	$2.55	$ 2.10
Diluted	$0.62	$ 0.49	$2.49	$ 2.05

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

4. INVESTMENTS

In May 2018, we entered into a $5.0 million strategic investment in an equity position of a private company. As part of the agreement, we committed to an additional $5.0 million purchase of equity securities to be invested no later than August 31, 2018. Our intent was to offer this investment opportunity to our current and prospective clients, members of our Board of Directors and employees, but to the extent these parties did not invest the full $5.0 million, we were obligated to make an additional investment to cover any shortfall. Based on investments made by these parties during the third quarter of 2018, we were required to purchase an additional $425,000 of equity securities in the private company in August 2018. Our $5.4 million investment is included in “Investments” on our Condensed Consolidated Balance Sheets.

As this investment represents a private company without a readily determinable fair value, the Company has elected to apply the measurement alternative of cost minus impairment, if any, plus or minus changes resulting from observable price changes. The Company will reassess whether our investment qualifies for the measurement alternative at each reporting period. In evaluating the investment for impairment or observable price changes, we will use inputs including recent financing events, as well as other available information regarding the private company's historical and forecasted performance. As of September 30, 2018, there were no observable price changes or indicators of impairment for this investment.

All other investments are carried at fair value on a recurring basis and are accounted for as trading securities. Trading securities are presented in the table below (in thousands):

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
September 30, 2018:				
U.S. Government and Government agency obligations	$51,194	$ 117	$ —	$ 51,311
Money market funds	9,978	—	—	9,978
Equity funds	9,333	545	(164)	9,714
Total trading securities	$70,505	$ 662	$ (164)	$ 71,003
December 31, 2017:				
U.S. Government and Government agency obligations	$29,367	$ 21	$ (15)	$ 29,373
Money market funds	9,736	—	—	9,736
Equity funds	11,578	657	(20)	12,215
Total trading securities	$50,681	$ 678	$ (35)	$ 51,324

As of September 30, 2018 and December 31, 2017, approximately $8.7 million and $10.7 million, respectively, in corporate funds were invested in Westwood Funds®, Westwood Common Trust Funds and Westwood Investment Funds Plc (the “UCITS Fund”). See Note 8 “Variable Interest Entities.”

5. FAIR VALUE MEASUREMENTS

We determine estimated fair values for 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 income taxes, other current assets, accounts payable and accrued liabilities, dividends payable, compensation and benefits payable and income taxes payable approximates their carrying value due to their short-term maturities. The carrying amount of investments designated as “trading” securities, primarily U.S. Government and Government agency obligations, money market funds, Westwood Funds® mutual funds, the UCITS Fund and Westwood Trust common trust fund shares, equals their fair value based on prices quoted in active markets and, with respect to common trust funds, the net asset value of the shares held as reported by each fund. Market values of our money market holdings generally do not fluctuate. Our strategic investment in a private company discussed in Note 4 “Investments” is excluded from the recurring fair value table shown below, as we have elected to apply the measurement alternative for this investment.

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

ASC 820, Fair Value Measurements, defines fair value, establishes a framework for measuring fair value and requires 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 – significant unobservable inputs where there is little or no market activity

The following table summarizes the values of our investments measured at fair value on a recurring basis within the fair value hierarchy as of the dates indicated (in thousands):

	Level 1	Level 2	Level 3	Investments Measured at NAV (1)	Total
As of September 30, 2018:					
Investments in trading securities	$68,567	$ —	$ —	$ 2,436	$71,003
Total assets measured at fair value	$68,567	$ —	$ —	$ 2,436	$71,003
As of December 31, 2017:					
Investments in trading securities	$48,998	$ —	$ —	$ 2,326	$51,324
Total assets measured at fair value	$48,998	$ —	$ —	$ 2,326	$51,324

(1) Comprised of certain investments measured at fair value using net asset value ("NAV") as a practical expedient. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented on our Condensed Consolidated Balance Sheets.

6. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

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 completed our annual goodwill impairment assessment during the third quarter of 2018 and determined that no impairment loss was required. No impairments on goodwill were recorded during the three or nine months ended September 30, 2018 or 2017.

Changes in the balance of Goodwill for the periods presented are as follows (in thousands):

	Goodwill
Balance as of December 31, 2017	$27,144
Omaha divestiture	(7,340)
Balance as of September 30, 2018	$19,804

Other Intangible Assets

Our intangible assets represent the acquisition date fair value of acquired client relationships, trade names, non-compete agreements and internally developed software 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. No impairments on intangible assets were recorded during the three or nine months ended September 30, 2018 or 2017.

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

Changes in the balance of Intangible assets, net for the periods presented are as follows (in thousands):

	Intangible assets, net
Balance as of December 31, 2017	$ 19,804
Amortization	(1,255)
Omaha divestiture [(1)]	(2,170)
Balance as of September 30, 2018	$ 16,379

(1) Related to client relationships

7. STOCKHOLDERS' EQUITY

Accumulated Other Comprehensive Loss

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

	As of September 30, 2018	As of December 31, 2017
Foreign currency translation adjustment	$ (2,826)	$ (1,764)
Accumulated other comprehensive loss	$ (2,826)	$ (1,764)

8. VARIABLE INTEREST ENTITIES

We have evaluated (i) our advisory relationships with the UCITS Fund and the Westwood Funds®, (ii) our relationship as sponsor of the Common Trust Funds (“CTFs”) and managing member of the private equity funds Westwood Hospitality Fund I, LLC and Westwood Technology Fund LP (collectively the “Private Equity Funds”) and (iii) the private company discussed in Note 4 “Investments” (“Private Equity”) to determine whether each of these entities is a variable interest entity (“VIE”) or voting ownership entity (“VOE”). Based on our analysis, we determined that the CTFs and Private Equity Funds were VIEs, as the at-risk equity holders do not have the ability to direct the activities that most significantly impact the entity’s economic performance, and the Company and its representatives have a majority control of the entities' respective boards of directors and can influence the respective entities' management and affairs. Prior to the sale of our Omaha-based operations, we also considered our advisory relationship with ten limited liability companies (“LLCs”) as VIEs, but as of September 30, 2018, we no longer serve as the managing member of the funds and do not control the activities that most significantly impact the entities' economic performance. Therefore these LLCs are no longer considered VIEs. Although we have related parties on the UCITS Fund board of directors, the shareholders have rights to remove the current directors by a simple majority vote and so we determined that the UCITS Fund is not a VIE. As the Company and its representatives do not have representation on the Westwood Funds® or the Private Equity independent boards of directors, which direct the activities that most significantly impact the entities' economic performance, we determined that the Westwood Funds® and the Private Equity were not VIEs. Therefore, the UCITS Fund, Westwood Funds® and Private Equity should be analyzed under the VOE consolidation method. Based on our analysis of our investments in these entities for the periods ending September 30, 2018 and December 31, 2017, we have not consolidated the CTFs, Private Equity Funds or LLCs under the VIE method or the UCITS Fund, Westwood Funds® or Private Equity under the VOE method, and therefore the financial results of these entities are not included in the Company’s consolidated financial results.

As of September 30, 2018 and December 31, 2017, our seed investments aggregated approximately $8.7 million and $10.7 million, respectively, in the CTFs, the Westwood Funds and the UCITS Fund. The seed investments were provided for the sole purpose of showing the economic substance needed to establish the funds or sub-funds. The Company's seed investments in these funds are included in “Investments, at fair value” on our Condensed Consolidated Balance Sheets.

We have not otherwise 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 entities. Our seed investments in the above-mentioned Westwood Funds®, the UCITS Fund and the CTFs are accounted for as investments in accordance with our other investments described in Note 4 "Investments." We recognized fee revenue from the Westwood VIEs and Westwood VOEs of approximately \$11.7 million and \$13.2 million for the three months ended September 30, 2018 and 2017, respectively. We recognized fee revenue from the Westwood VIEs and Westwood VOEs of approximately \$36.3 million and \$39.1 million for the nine months ended September 30, 2018 and 2017, respectively.

The following table displays the assets under management, the amounts of our seed investments included in "Investments" on our consolidated balance sheets, and the risk of loss in each vehicle (in millions):

	As of September 30, 2018		
	Assets Under Management	Corporate Investment	Amount at Risk
VIEs/VOEs:			
Westwood Funds®	$4,031	$ 6	$ 6
Common Trust Funds	2,079	3	3
UCITS Fund	388	—	—
Private Equity Funds	8	—	—
Private Equity	—	5	5
All other assets:			
Private Wealth	2,703		
Institutional	11,591		
Total Assets Under Management	$20,800		

9. REVENUE

Adoption of ASC 2014-09 Revenue from Contracts with Customers (Topic 606)

On January 1, 2018, we adopted ASU 2016-10 using the modified retrospective method applied to those contracts that were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606 while prior period amounts continue to be reported in accordance with our historic accounting under Topic 605.

We analyzed the revenue from prior periods and determined no material adjustments to opening retained earnings were necessary as the updated guidance is consistent with our historical revenue recognition methodology.

Revenue Recognition

Revenues are recognized when the performance obligation (the investment management and advisory or trust services provided to the client) defined by the investment advisory or sub-advisory agreement is satisfied. For each performance obligation, we determine at contract inception whether the revenue satisfies over time or at a point in time. We derive our revenues from investment advisory fees, trust fees and other sources of revenues. Advisory and Trust fees are calculated based on a percentage of assets under management and the performance obligation is realized over the current calendar quarter. Once clients receive our investment advisory services we have an enforceable right to payment.

Advisory Fee Revenues

Our advisory fees are generated by Westwood Management and Westwood International, which manage client accounts under investment advisory and sub-advisory agreements. Advisory fees are typically calculated based on a percentage of assets under management and are paid in accordance with the terms of the agreements. Advisory fees are paid quarterly in advance based on assets under management on the last day of the preceding quarter, quarterly in arrears based on assets under management on the last day of the quarter just ended or are based on a daily or monthly analysis of assets under management for the stated period. We recognize advisory fee revenues as services are rendered. Since our advance paying clients' billing periods coincide with the calendar quarter to which such payments relate, revenue is recognized within the quarter and our condensed consolidated financial statements contain no deferred advisory fee revenues. Advisory clients typically consist of institutional and mutual fund accounts.

Institutional investors include separate accounts of (i) corporate pension and profit sharing plans, public employee retirement funds, Taft Hartley plans, endowments, foundations and individuals; (ii) subadvisory relationships where Westwood provides investment management services for funds offered by other financial institutions; (iii) pooled investment vehicles, including the UCITS Fund and collective investment trusts; and (iv) managed account relationships with brokerage firms and other registered investment advisors that offer Westwood products to their customers.

Mutual funds include the Westwood Funds®, a family of mutual funds for which Westwood Management serves as advisor. These funds are available to individual investors, as well as offered as part of our investment strategies for institutional investors and private wealth accounts.

Arrangements with Performance Based Obligations

A limited number of our advisory clients have a contractual performance-based fee component in their contracts, which generates additional revenues if we outperform a specified index over a specific period of time. The revenue is based on future market performance and is susceptible to factors outside our control. We cannot conclude that a significant reversal in the cumulative amount of revenue recognized will not occur during the measurement period, and therefore the revenue is recorded at the end of the measurement period when the performance obligation has been satisfied.

Trust Fee Revenues

Our trust fees are generated by Westwood Trust pursuant to trust or custodial agreements. Trust fees are separately negotiated with each client and are generally based on a percentage of assets under management. Westwood Trust also provides trust services to a small number of clients on a fixed fee basis. The fees for most of our trust clients are calculated quarterly in arrears, based on a daily average of assets under management for the quarter. Since billing periods for most of Westwood Trust’s clients coincide with the calendar quarter, revenue is fully recognized within the quarter and our Condensed Consolidated Financial Statements do not contain a significant amount of deferred trust fee revenues.

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

Revenue Disaggregated

Sales taxes are excluded from revenues. The following table presents our revenue disaggregated by account type (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Advisory Fees:				
Institutional	$14,426	$17,610	$46,815	$51,263
Mutual Funds	7,527	7,724	23,030	22,356
Private Wealth	70	—	134	—
Performance-based	—	—	2,984	1,417
Trust Fees	7,191	7,858	22,265	23,570
Other	640	300	953	1,265
Total revenues	$29,854	$33,492	$96,181	$99,871

We have clients in various locations around the world. The following table presents our revenue disaggregated by our clients' geographical locations (in thousands):

Three Months Ended September 30, 2018	Advisory	Trust	Performance-based	Other	Total
Asia	$853	$—	$ —	$—	$853
Australia	927	—	—	—	927
Canada	1,707	—	—	38	1,745
Europe	1,249	—	—	—	1,249
United States	17,287	7,191	—	602	25,080
Total	$22,023	$7,191	$ —	$640	$29,854
Nine Months Ended September 30, 2018					
Asia	$3,520	$—	$ —	$—	$3,520
Australia	2,923	—	—	—	2,923
Canada	5,177	—	—	124	5,301
Europe	3,839	—	—	—	3,839
United States	54,520	22,265	2,984	829	80,598
Total	$69,979	$22,265	$ 2,984	$953	$96,181

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

Three Months Ended September 30, 2017	Advisory	Trust	Performance-based	Other	Total
Asia	$1,649	$—	$ —	$—	$1,649
Australia	944	—	—	—	944
Canada	2,219	—	—	516	2,735
Europe	946	—	—	—	946
United States	19,576	7,858	—	(216)	27,218
Total	$25,334	$7,858	$ —	$300	$33,492
Nine Months Ended September 30, 2017					
Asia	$4,696	$—	$ —	$—	$4,696
Australia	2,371	—	—	—	2,371
Canada	6,351	—	—	738	7,089
Europe	3,065	—	—	—	3,065
United States	57,136	23,570	1,417	527	82,650
Total	$73,619	$23,570	$ 1,417	$1,265	$99,871

10. LONG-TERM INCENTIVE COMPENSATION
Restricted Stock Awards
We have issued restricted shares to our employees and non-employee directors. The Fifth Amended and Restated Westwood Holdings Group, Inc. Stock Incentive Plan (the “Plan”) reserves shares of Westwood common stock for issuance to eligible employees, directors and consultants of Westwood or its subsidiaries in the form of restricted stock. In April 2018, stockholders approved an additional 200,000 shares to be authorized under the Plan, increasing the total number of shares issuable under the Plan (including predecessor plans to the Plan) to 4,848,100 shares. At September 30, 2018, approximately 409,000 shares remain available for issuance under the Plan.
The following table presents the total stock-based compensation expense recorded for stock-based compensation arrangements for the periods indicated (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Service condition stock-based compensation expense	$2,434	$2,591	$7,759	$7,828
Performance condition stock-based compensation expense	1,107	1,454	3,471	3,949
Stock-based compensation expense under the Plan	3,541	4,045	11,230	11,777
Canadian Plan stock-based compensation expense	154	188	428	521
Total stock-based compensation expense	$3,695	$4,233	$11,658	$12,298

Restricted Stock
Under the Plan we have granted to employees and non-employee directors restricted stock subject to service conditions and to certain key employees restricted stock subject to both service and performance conditions.
As of September 30, 2018, there was approximately $23.8 million of unrecognized compensation cost for restricted stock grants under the Plan, which we expect to recognize over a weighted-average period of 2.2 years. Our two types of restricted stock grants under the Plan are discussed below.

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

Restricted Stock Subject Only to a Service Condition
We calculate compensation cost for restricted stock grants by using the fair market value of our common stock at the date of grant, the number of shares issued and an adjustment for restrictions on dividends. This compensation cost is amortized on a straight-line basis over the applicable vesting period, with adjustments for forfeitures recorded as they occur.
The following table details the status and changes in our restricted stock grants subject only to a service condition for the nine months ended September 30, 2018:

	Shares	Weighted Average Grant Date Fair Value
Non-vested, January 1, 2018	519,375	$ 55.44
Granted	172,366	55.92
Vested	(203,504)	53.49
Forfeited	(29,229)	56.55
Non-vested, September 30, 2018	459,008	$ 56.42

Restricted Stock Subject to Service and Performance Conditions
Under the Plan, certain key employees were provided agreements for grants of restricted shares that vest over multiple year periods subject to achieving annual performance goals established by the Compensation Committee of Westwood's Board of Directors. Each year the Compensation Committee establishes specific goals for that year's vesting of the restricted shares. The date that the Compensation Committee establishes annual goals is considered to be the grant date and the fair value measurement date to determine expense on the shares that are likely to vest. The vesting period ends when the Compensation Committee formally approves the performance-based restricted stock vesting based on the specific performance goals from the Company's audited consolidated financial statements. If a portion of the performance-based restricted shares does not vest, no compensation expense is recognized for that portion and any previously recognized compensation expense related to shares that do not vest is reversed.
In March 2018, the Compensation Committee established the fiscal 2018 goal for our Chief Executive Officer and Chief Investment Officer as Income before income taxes of $20.0 million for 50% of their respective awards and an Income before income taxes target of $36.0 million (ranging from 25% of target for threshold performance of $32.0 million to 185% of target for maximum performance of $44.5 million) for the remaining 50% of their respective awards. For certain other key employees, the Compensation Committee established fiscal 2018 goals based on various departmental and company-wide performance goals, including Income before income taxes of at least $20.0 million. During the first nine months of 2018, we recorded expense related to the applicable percentage of the performance-based restricted shares expected to meet or exceed the performance goals needed to earn the shares.
The following table details the status and changes in our restricted stock grants subject to service and performance conditions for the nine months ended September 30, 2018:

	Shares	Weighted Average Grant Date Fair Value
Non-vested, January 1, 2018	165,918	$ 55.85
Granted	84,829	55.46
Vested	(98,281)	55.81
Forfeited	—	—

Non-vested, September 30, 2018	152,466	$ 55.66

15

Canadian Plan

The Share Award Plan of Westwood Holdings Group, Inc. for Service Provided in Canada to its Subsidiaries (the "Canadian Plan") provides compensation in the form of common stock for services performed by employees of Westwood International. Under the Canadian Plan, no more than $10 million CDN ($7.7 million in U.S. Dollars using the exchange rate on September 30, 2018) may be funded to the plan trustee for purchases of common stock with respect to awards granted under the Canadian Plan. At September 30, 2018, approximately $3.5 million CDN ($2.7 million in U.S. Dollars using the exchange rate on September 30, 2018) remains available for issuance under the Canadian Plan, or approximately 52,064 shares based on the closing share price of our stock of $51.74 as of September 30, 2018. During the first nine months of 2018, the trust formed pursuant to the Canadian Plan purchased in the open market 13,031 Westwood common shares for approximately $726,000. As of September 30, 2018, the trust holds 46,358 shares of Westwood common stock. As of September 30, 2018, unrecognized compensation cost related to restricted stock grants under the Canadian Plan totaled $0.8 million, which we expect to recognize over a weighted-average period of 1.8 years.

Mutual Fund Share Incentive Awards

We grant annually to certain employees mutual fund incentive awards, which are bonus awards based on our mutual funds achieving specific performance goals. Awards granted are notionally credited to a participant account maintained by us that contains a number of mutual fund shares equal to the award amount divided by the net closing value of a fund share on the date the amount is credited to the account. We maintain the award in a corporate investment account until vesting. The investment may increase or decrease based on changes in the value of the mutual fund shares awarded, including reinvested income from the mutual funds during the vesting period. Unvested mutual fund awards are included under "Investments, at fair value" on our Condensed Consolidated Balance Sheets. Awards vest over approximately two years of service following the year in which the participant earned the award. We begin accruing a liability for mutual fund incentive awards when we believe it is probable that the award will be earned and record expense for these awards over the service period of the award, which is three years. During the year in which the amount of the award is determined, we record expense based on the expected value of the award. After the award is earned, we record expense based on the value of the shares awarded and the percentage of the vesting period that has elapsed. Our liability under these awards may increase or decrease based on changes in the value of the mutual fund shares awarded, including reinvested income from the mutual funds during the vesting period. Upon vesting, participants receive the value of the mutual fund share awards adjusted for earnings or losses attributable to the underlying mutual funds. For the three months ended September 30, 2018 and 2017, we recorded expense of approximately $89,000 and $281,000, respectively, related to mutual fund share incentive awards. For the nine months ended September 30, 2018 and 2017, we recorded expense of approximately $274,000 and $819,000, respectively, related to mutual fund share incentive awards. As of September 30, 2018 and December 31, 2017, we had an accrued liability of approximately $606,000 and $1.8 million, respectively, related to mutual fund share incentive awards.

11. INCOME TAXES

Our effective income tax rate was 24.9% for the third quarter of 2018, compared with 28.2% for the third quarter of 2017. The current quarter rate benefited from the decrease in the U.S. corporate income tax rate under the Tax Cuts and Jobs Act signed into law in December 2017, partially offset by tax expense of $251,000 related to completion of a state tax audit, while the prior year quarter benefited from the tax impact of our legal settlement with AGF.

Our effective income tax rate was 25.3% for the nine months ended September 30, 2018, compared with 29.1% for the nine months ended September 30, 2017. The current year-to-date rate benefited from the decrease in the U.S. corporate income tax rate under the Tax Cuts and Jobs Act signed into law in December 2017, partially offset by tax expense related to completion of a state tax audit, while the first nine months of 2017 benefited from the tax impact of our legal settlement with AGF and included a $1.0 million tax benefit related to the adoption of ASU 2016-09 Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting. Excluding this discrete tax benefit, our effective tax rate would have been 33.0% for the nine months ended September 30, 2017.

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

Tax Reform Act

On December 22, 2017, the SEC staff issued Staff Accounting Bulletin No. 118 (“SAB 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 Reform Act. During 2017, we provisionally recognized the incremental tax impacts related to deemed repatriated earnings and the revaluation of deferred tax assets and liabilities and included these amounts in our Consolidated Financial Statements for the year ended December 31, 2017. We completed the accounting for our 2017 U.S. corporate income tax return in the third quarter of 2018 and made no significant changes to the amounts provisionally recognized.

Tax Audit

The Company is subject to taxation in the United States and various state and foreign jurisdictions, and during the first nine months of 2018, our 2014 tax return was audited in a state jurisdiction in which we operate. The audit was completed in September 2018, and we recorded and paid income taxes and interest expense of $251,000 and $81,000, respectively, during the third quarter of 2018, which are included within “Provision for income taxes” and “General and administrative expenses,” respectively, in our Condensed Consolidated Statements of Comprehensive Income. No penalties were assessed by the state.

12. RELATED PARTY TRANSACTIONS

Some of our directors, executive officers and their affiliates invest personal funds directly in trust accounts that we manage. For the three months ended September 30, 2018 and 2017, we recorded trust fees from these accounts of $89,000 and $92,000, respectively. For the nine months ended September 30, 2018 and 2017, we recorded trust fees from these accounts of $276,000 and $277,000, respectively. There was $89,000 and $98,000 due from these accounts as of September 30, 2018 and December 31, 2017, respectively.

The Company engages in transactions with its affiliates in the ordinary course of business. Westwood International and Westwood Management provide investment advisory services to the UCITS Fund and the Westwood Funds®. Certain members of our management serve on the board of directors of the UCITS Fund, and we have capital invested in three of the Westwood Funds®. Under the terms of the investment advisory agreements, the Company earns quarterly fees paid by clients of the fund or by the funds directly. The fees are based on negotiated fee schedules applied to assets under management. These fees are commensurate with market rates. For the three months ended September 30, 2018 and 2017, the Company earned approximately $1.0 million and $1.1 million, respectively, in fees from the affiliated funds. For the nine months ended September 30, 2018 and 2017, the Company earned approximately $3.3 million and $2.8 million, respectively, in fees from the affiliated funds. These fees do not include fees paid directly to Westwood International by certain clients invested in the UCITS Fund that have an investment management agreement with Westwood International. As of September 30, 2018 and December 31, 2017, $329,000 and $423,000, respectively, of these fees were outstanding and included in “Accounts receivable” on our Condensed Consolidated Balance Sheets.

As discussed in Note 4 “Investments,” the Company made a strategic investment in an equity position of a private company during the second and third quarters of 2018. We previously entered into a separate agreement with this private company to implement a portfolio management product. For the three and nine months ended September 30, 2018, we incurred approximately $162,000 and $767,000, respectively, in expenses to this company, which are included in “Information technology expenses” on our Condensed Consolidated Statements of Comprehensive Income. The Company did not incur any similar expenses during the three or nine months ended September 30, 2017.

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

13. COMMITMENTS AND CONTINGENCIES

Litigation

On August 3, 2012, AGF Management Limited and AGF Investments Inc. (collectively, “AGF”) filed a lawsuit in the Ontario Superior Court of Justice against Westwood, certain Westwood employees and the executive recruiting firm of Warren International, LLC (“Warren”). The action related to the hiring of certain members of Westwood’s global and emerging markets investment team previously employed by AGF. On November 5, 2012, Westwood responded to AGF’s lawsuit with a counterclaim, and on November 6, 2012, AGF filed a second lawsuit against Westwood, Westwood Management and an employee of Westwood International.

On October 13, 2017, we reached a settlement with AGF that provided for the dismissal of all claims, with prejudice and without any admission of liability. We agreed to pay AGF a one-time payment of $10.0 million CDN, half of which was covered by our insurance. During 2017, we recorded a net $4.0 million ($5.0 million CDN) charge related to the settlement and associated insurance coverage, with a $4.0 million ($5.0 million CDN) receivable from our insurance provider included in “Other current assets” on our Condensed Consolidated Balance Sheets at December 31, 2017. We received the insurance proceeds of $4.0 million during the nine months ended September 30, 2018 and had no receivable related to the settlement at September 30, 2018.

Our policy is to not accrue legal fees and directly-related costs as part of potential loss contingencies. We have agreed with our Directors & Officers insurance provider that 50% of the defense costs related to both AGF claims, excluding Westwood’s counterclaim against AGF, are covered by insurance. We expense legal fees and directly related costs as incurred. We received the remaining insurance proceeds related to AGF legal expenses during the nine months ended September 30, 2018 and had no receivable at quarter-end. We had a receivable of approximately $212,000 as of December 31, 2017, which represented our then current minimum estimate of expenses that we expected to recover under our insurance policy. This receivable is included in “Other current assets” on our Condensed Consolidated Balance Sheets.

14. SEGMENT REPORTING

We operate two segments: Advisory and Trust. These segments are managed separately based on the types of products and services offered and their related client bases. The Company’s segment information is prepared on the same basis that management reviews the financial information for operational decision-making purposes. The Company’s chief operating decision maker, our Chief Executive Officer, evaluates the performance of our segments based primarily on fee revenues and Economic Earnings. Westwood Holdings Group, Inc., the parent company of Advisory and Trust, does not have revenues and is the entity in which we record typical holding company expenses including employee compensation and benefits for holding company employees, directors’ fees and investor relations costs. All segment accounting policies are the same as those described in the summary of significant accounting policies. Intersegment balances that eliminate in consolidation have been applied to the appropriate segment.

Advisory

Our Advisory segment provides investment advisory services to corporate retirement plans, public retirement plans, endowments, foundations, individuals, the Westwood Funds®, and the UCITS Fund, as well as investment subadvisory services to mutual funds and our Trust segment. Westwood Management Corp. and Westwood International, which provide investment advisory services to clients of similar type, are included in our Advisory segment along with Westwood Advisors, L.L.C.

Trust

Trust provides trust and custodial services and participation in common trust funds that it sponsors to institutions and high net worth individuals. Westwood Trust is included in our Trust segment.

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

(in thousands)	Advisory	Trust	Westwood Holdings	Eliminations	Consolidated
Three Months Ended September 30, 2018					
Net fee revenues from external sources	$22,023	$7,191	$—	$—	$ 29,214
Net intersegment revenues	1,756	58	—	(1,814)	—
Net interest and dividend revenue	187	52	—	—	239
Other, net	389	12	—	—	401
Total revenues	$24,355	$7,313	$—	$(1,814)	$ 29,854
Economic Earnings	$10,553	$1,357	$(2,369)	$—	$ 9,541
Less: Restricted stock expense					3,695
Intangible amortization					419
Deferred taxes on goodwill					59
Net income					$ 5,368
Segment assets	$220,138	$60,658	$16,839	$(105,008)	$ 192,627
Segment goodwill	$3,403	$16,401	$—	$—	$ 19,804
Three Months Ended September 30, 2017					
Net fee revenues from external sources	$25,334	$7,858	$—	$—	$ 33,192
Net intersegment revenues	2,026	57	—	(2,083)	—
Net interest and dividend revenue	111	43	—	—	154
Other, net	157	(11)	—	—	146
Total revenues	$27,628	$7,947	$—	$(2,083)	$ 33,492
Economic Earnings	$8,786	$1,560	$(1,356)	$—	$ 8,990
Less: Restricted stock expense					4,233
Intangible amortization					469
Deferred taxes on goodwill					156
Net income					$ 4,132
Segment assets	$208,444	$73,170	$18,388	$(108,640)	$ 191,362
Segment goodwill	$5,219	$21,925	$—	$—	$ 27,144

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

(in thousands)	Advisory	Trust	Westwood Holdings	Eliminations	Consolidated
Nine Months Ended September 30, 2018					
Net fee revenues from external sources	$72,963	$22,265	$—	$—	$ 95,228
Net intersegment revenues	5,639	171	—	(5,810)	—
Net interest and dividend revenue	464	152	—	—	616
Other	331	6	—	—	337
Total revenues	$79,397	$22,594	$—	$ (5,810)	$ 96,181
Economic Earnings	$37,463	$4,034	$(7,069)	$—	$ 34,428
Less: Restricted stock expense					11,658
Intangible amortization					1,255
Deferred taxes on goodwill					177
Net income					$ 21,338
Nine Months Ended September 30, 2017					
Net fee revenues from external sources	$75,036	$23,570	$—	$—	$ 98,606
Net intersegment revenues	6,050	160	—	(6,210)	—
Net interest and dividend revenue	391	67	—	—	458
Other	811	(4)	—	—	807
Total revenues	$82,288	$23,793	$—	$ (6,210)	$ 99,871
Economic Earnings	$31,372	$4,528	$(4,592)	$—	$ 31,308
Less: Restricted stock expense					12,298
Intangible amortization					1,449
Deferred taxes on goodwill					469
Net income					$ 17,092

We are providing a performance measure that we refer to as Economic Earnings. Our management and the Board of Directors review Economic Earnings to evaluate our ongoing performance, allocate resources and determine our dividend policy. We also believe that this performance measure is useful for management and investors when evaluating our underlying operating and financial performance and our available resources.

In calculating Economic Earnings, we add to net income the non-cash expense associated with equity-based compensation awards of restricted stock, amortization of intangible assets and the deferred taxes related to the tax-basis amortization of goodwill. Although depreciation on property and equipment is a non-cash expense, we do not add it back when calculating Economic Earnings because depreciation charges represent a decline in the value of the related assets that will ultimately require replacement.

The following tables provide a reconciliation of Net income to Economic Earnings (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$5,368	$4,132	$21,338	$17,092
Add: Stock-based compensation expense	3,695	4,233	11,658	12,298
Add: Intangible amortization	419	469	1,255	1,449
Add: Tax benefit from goodwill amortization	59	156	177	469
Economic Earnings	$9,541	$8,990	$34,428	$31,308

15. SUBSEQUENT EVENTS

Dividend Declared

In October 2018, Westwood’s Board of Directors declared a quarterly cash dividend of $0.72 per common share, an increase of 6% from the previous quarterly dividend rate, payable on January 2, 2019, to stockholders of record on December 7, 2018.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

Statements in this report and the Annual Report to Stockholders that are not purely historical facts, including, without limitation, statements about our expected future financial position, results of operations or cash flows, as well as other statements including, without limitation, words such as “anticipate,” “believe,” “plan,” “estimate,” “expect,” “intend,” “should, “could,” “goal,” “may,” “target,” “designed,” “on track,” “comfortable with,” “optimistic” and other similar expressions, const forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Actual results and the timing of some events could differ materially from those projected in or contemplated by the forward-looking statements due to a number of factors, including, without limitation, the risks described under “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC, and those risks set forth below:

- the composition and market value of our assets under management;
- regulations adversely affecting the financial services industry;
- competition in the investment management industry;
- our assets under management includes investments in foreign companies;
- our ability to develop and market new investment strategies successfully;
- our reputation and our relationships with current and potential customers;
- our ability to attract and retain qualified personnel;
- our ability to perform operational tasks;
- our ability to maintain effective cyber security;
- our ability to identify and execute on our strategic initiatives;
- our ability to select and oversee third-party vendors;
- our ability to maintain effective information systems;
- litigation risks;
- our ability to properly address conflicts of interest;
- our ability to maintain adequate insurance coverage;
- our ability to maintain an effective system of internal controls;
- our ability to maintain our fee structure in light of competitive fee pressures;
- our relationships with investment consulting firms; and
- the significant concentration of our revenues in a small number of customers.

You should not unduly rely on these forward-looking statements, which speak only as of the date of this report. We are not obligated and do not undertake an obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events or otherwise.

Overview

We manage investment assets and provide services for our clients through our subsidiaries, Westwood Management Corp. and Westwood Advisors, L.L.C. (each of which is an SEC-registered investment advisor and referred to hereinafter together as “Westwood Management”), Westwood International Advisors Inc. (“Westwood International”) and Westwood Trust. Westwood Management provides investment advisory services to institutional investors, a family of mutual funds called the Westwood Funds®, other mutual funds, an Ireland-domiciled fund organized pursuant to the European Union’s Undertakings for Collective Investment in Transferable Securities (the “UCITS Fund”), individual investors and clients of Westwood Trust. Westwood International provides investment advisory services to institutional clients, the Westwood Funds®, other mutual funds, the UCITS Fund and clients of Westwood Trust. Westwood Trust provides trust and custodial services and participation in self-sponsored common trust funds to institutions and high net worth individuals. Our revenues are generally derived from fees based on a percentage of assets under management.

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 gain on the sale of $524,000, which is included as “Gain on sale of operations” on our Consolidated Statement of Comprehensive Income. 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.

Revenues

We derive our revenues from investment advisory fees, trust fees and other revenues. Our advisory fees are generated by Westwood Management and Westwood International, which manage client accounts under investment advisory and subadvisory agreements. Advisory fees are typically calculated based on a percentage of assets under management and are paid in accordance with the terms of the agreements. Advisory fees are paid quarterly in advance based on assets under management on the last day of the preceding quarter, quarterly in arrears based on assets under management on the last day of the quarter just ended or are based on a daily or monthly analysis of assets under management for the stated period. We recognize advisory fee revenues as services are rendered. A limited number of our clients have a contractual performance-based fee component in their contracts, which generates additional revenues if we outperform a specified index over a specific period of time. We record revenues from performance-based fees at the end of the measurement period. Since our advance paying clients' billing periods coincide with the calendar quarter to which such payments relate, revenue is recognized within the quarter and our Condensed Consolidated Financial Statements contain no deferred advisory fee revenues.

Our trust fees are generated by Westwood Trust pursuant to trust or custodial agreements. Trust fees are separately negotiated with each client and are generally based on a percentage of assets under management. Westwood Trust also provides trust services to a small number of clients on a fixed fee basis. Trust fees for most of our trust clients are calculated quarterly in arrears, based on a daily average of assets under management for the quarter. Since billing periods for most of Westwood Trust’s clients coincide with the calendar quarter, revenue is fully recognized within the quarter and our Condensed Consolidated Financial Statements do not contain a significant amount of deferred trust fee revenues.

Our other revenues generally consist of interest and investment income. Although we generally invest most of our cash in U.S. Treasury securities, we also invest in equity and fixed income instruments and money market funds, including seed money for new investment strategies.

Employee Compensation and Benefits

Employee compensation and benefits expenses generally consist of salaries, incentive compensation, equity-based compensation and benefits.

Sales and Marketing

Sales and marketing expenses relate to our marketing efforts, including travel and entertainment, direct marketing and advertising costs.

Westwood Mutual Funds

Westwood Mutual Funds expenses relate to our marketing, distribution and administration of the Westwood Funds®.

Information Technology

Information technology expenses are generally costs associated with proprietary investment research tools, maintenance and support, computing hardware, software licenses, telecommunications and other related costs.

Professional Services

Professional services expenses generally consist of costs associated with subadvisory fees, audit, tax, legal and other professional services.

Legal Settlements

Legal settlement expenses consist of settlements related to litigation claims, net of any amounts covered by our insurance policies.

General and Administrative

General and administrative expenses generally consist of costs associated with the lease of our office space, amortization, depreciation, insurance, custody expense, Board of Directors' fees, investor relations, licenses and fees, office supplies, foreign currency transaction gains/losses and other miscellaneous expenses.

Gain on Sale of Operations

Gain on sale of operations includes the gain on the sale of our Omaha-based component of our Private Wealth business.

Assets Under Management

Assets under management ("AUM") decreased $2.8 billion to $20.8 billion at September 30, 2018 compared with $23.6 billion at September 30, 2017. The average of beginning and ending assets under management for the third quarter of 2018 was $21.2 billion compared to $23.1 billion for the third quarter of 2017. These decreases are due to net outflows, including $1.2 billion of outflows related to the sale of the Omaha-based component of our Private Wealth business, partially offset by market appreciation, over the last twelve months.

The following table displays assets under management as of September 30, 2018 and 2017:

	As of September 30,		% Change September 30, 2018 vs. September 30, 2017
	2018	2017	
	(in millions)		
Institutional	$11,979	$13,658	(12)%
Private Wealth	4,790	5,822	(18)
Mutual Funds	4,031	4,144	(3)
Total Assets Under Management[(1)]	$20,800	$23,624	(12)%

(1) AUM excludes $268 million and $362 million of assets under advisement ("AUA") as of September 30, 2018 and 2017, respectively, related to our model portfolios for which we provided consulting advice but for which we did not have direct discretionary investment authority.

- Institutional includes (i) separate accounts of corporate pension and profit sharing plans, public employee retirement funds, Taft Hartley plans, endowments, foundations and individuals; (ii) subadvisory relationships where Westwood provides investment management services for funds offered by other financial institutions; (iii) pooled investment vehicles, including the UCITS Fund and collective investment trusts; and (iv) managed account relationships with brokerage firms and other registered investment advisors that offer Westwood products to their customers.
- Private Wealth includes assets for which Westwood Trust provides trust and custodial services and participation in common trust funds that it sponsors to institutions and high net worth individuals pursuant to trust or custodial agreements and assets for which Westwood Advisors, L.L.C. provides advisory services to high net worth individuals. Investment subadvisory services are provided for the common trust funds by Westwood Management, Westwood International and external, unaffiliated subadvisors. For certain assets in this category, Westwood Trust currently provides limited custody services for a minimal or no fee, viewing these assets as potentially converting to fee-generating managed assets in the future. As an example, some assets in this category consist of low-basis stock currently held in custody for clients where we believe such assets may convert to fee-generating managed assets upon an inter-generational transfer of wealth.
- Mutual Funds include the Westwood Funds®, a family of mutual funds for which Westwood Management serves as advisor. These funds are available to individual investors, as well as offered as part of our investment strategies for institutional and private wealth accounts.

Roll-Forward of Assets Under Management

(in millions)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Institutional				
Beginning of period assets	$12,457	$12,773	$14,421	$11,911
Inflows[1]	402	1,113	1,187	2,173
Outflows	(1,265)	(659)	(3,858)	(1,954)
Net flows	(863)	454	(2,671)	219
Market appreciation	385	431	229	1,528
Net change	(478)	885	(2,442)	1,747
End of period assets	$11,979	$13,658	$11,979	$13,658
Private Wealth				
Beginning of period assets	$4,935	$5,685	$5,566	$5,520
Inflows	106	194	293	509
Outflows[2]	(422)	(216)	(1,242)	(710)
Net flows	(316)	(22)	(949)	(201)
Market appreciation	171	159	173	503
Net change	(145)	137	(776)	302
End of period assets	$4,790	$5,822	$4,790	$5,822
Mutual Funds				
Beginning of period assets	$4,199	$4,092	$4,242	$3,810
Inflows	164	293	716	792
Outflows	(466)	(334)	(1,034)	(803)
Net flows	(302)	(41)	(318)	(11)
Market appreciation	134	93	107	345
Net change	(168)	52	(211)	334
End of period assets	$4,031	$4,144	$4,031	$4,144
Total AUM				
Beginning of period assets	$21,591	$22,550	$24,229	$21,241
Inflows	672	1,600	2,196	3,474
Outflows	(2,153)	(1,209)	(6,134)	(3,467)
Net flows	(1,481)	391	(3,938)	7
Market appreciation	690	683	509	2,376
Net change	(791)	1,074	(3,429)	2,383
End of period assets	$20,800	$23,624	$20,800	$23,624

(1) Institutional inflows include approximately $713 million of assets related to a long-only convertibles fund, which transitioned from AUA to AUM during the third quarter of 2017.

(2) Private Wealth outflows include approximately $271 million and $802 million of assets related to the sale of the Omaha-based component of our Private Wealth business for the three and nine months ended September 30, 2018, respectively.

Three months ended September 30, 2018 and 2017

The $791 million decrease in assets under management for the three months ended September 30, 2018 was due to net outflows of $1.5 billion, partially offset by market appreciation of $690 million. Net outflows were primarily related to our Emerging Markets, SMidCap and Income Opportunity strategies and outflows related to the divestiture of our Omaha operations.

The $1.1 billion increase in assets under management for the three months ended September 30, 2017 was due to market appreciation of $683 million and net inflows of $391 million. Net inflows were primarily related to $713 million in our Strategic Global Convertibles strategy that transitioned from AUA to AUM in the third quarter of 2017, as well as net inflows to our Market Neutral Income and Emerging Markets strategies. These net inflows were partially offset by net outflows from our SMidCap strategies, Income Opportunity strategy and LargeCap Value strategy.

Nine months ended September 30, 2018 and 2017

The $3.4 billion decrease in assets under management for the nine months ended September 30, 2018 was due to net outflows of $3.9 billion, partially offset by market appreciation of $509 million. Net outflows were primarily related to our Emerging Markets, SMidCap, Income Opportunity and LargeCap Value strategies and outflows related to the divestiture of our Omaha operations, partially offset by net inflows to our SmallCap Value strategy.

The $2.4 billion increase in assets under management for the nine months ended September 30, 2017 was due to market appreciation of $2.4 billion and net inflows of $7 million. Net inflows were primarily related to approximately $713 million in our Strategic Global Convertibles strategy that transitioned from AUA to AUM in the third quarter of 2017 and net inflows to our SmallCap Value, Market Neutral Income and Emerging Markets strategies, partially offset by net outflows from our SMidCap strategies and LargeCap Value strategy.

Results of Operations

The following table (dollars in thousands) and discussion of our results of operations are based upon data derived from the condensed consolidated statements of comprehensive income contained in our condensed consolidated financial statements and should be read in conjunction with those statements included elsewhere in this report.

	Three Months Ended September 30,		Nine Months Ended September 30,		% Change Three Months Ended September 30, 2018 vs. September 30, 2017	% Change Nine Months Ended September 30, 2018 vs. September 30, 2017
	2018	2017	2018	2017		
Revenues:						
Advisory fees: asset-based	$22,023	$25,334	$69,979	$73,619	(13)%	(5)%
Advisory fees: performance-based	—	—	2,984	1,417	—	111
Trust fees	7,191	7,858	22,265	23,570	(8)	(6)
Other revenues	640	300	953	1,265	NM	NM
Total revenues	29,854	33,492	96,181	99,871	(11)	(4)
Expenses:						
Employee compensation and benefits	14,444	15,601	46,857	48,875	(7)	(4)
Sales and marketing	549	457	1,401	1,447	20	(3)
Westwood mutual funds	979	977	2,966	2,749	—	8
Information technology	2,332	1,855	6,753	5,494	26	23
Professional services	1,372	1,681	3,677	4,495	(18)	(18)
Legal Settlement	—	4,009	—	4,009	NM	NM
General and administrative	3,027	3,160	6,477	8,697	(4)	(26)
Total expenses	22,703	27,740	68,131	75,766	(18)	(10)
Net operating income	7,151	5,752	28,050	24,105	24	16
Gain on sale of operations	—	—	524	—	NM	NM
Income before income taxes	7,151	5,752	28,574	24,105	24	19
Provision for income taxes	1,783	1,620	7,236	7,013	10	3
Net income	$5,368	$4,132	$21,338	$17,092	30 %	25 %

NM Not meaningful

Three months ended September 30, 2018 compared to three months ended September 30, 2017

Total Revenues. Total revenues decreased $3.6 million, or 11%, to $29.9 million for the three months ended September 30, 2018 compared with $33.5 million for the three months ended September 30, 2017. Asset-based advisory fees decreased $3.3 million, or 13%, primarily due to lower average assets under management. Trust fees decreased $0.7 million, or 8%, primarily due to the sale of the Omaha-based component of our Private Wealth business.

Employee Compensation and Benefits. Employee compensation and benefits decreased $1.2 million, or 7%, to $14.4 million for the three months ended September 30, 2018 compared with $15.6 million for the three months ended September 30, 2017. The decrease was due to reductions in compensation relating to the sale of the Omaha-based component of our Private Wealth business and short- and long-term incentive compensation as a result of lower asset-based revenues as compared to the prior year quarter.

Legal Settlement. We recorded a net $4.0 million charge related to a legal settlement and associated insurance coverage during the third quarter of 2017. See further discussion of the settlement in Note 13 “Commitments and Contingencies” to our Condensed Consolidated Financial Statements included in Part I. Financial Information.

Provision for Income Taxes. The effective tax rate decreased to 24.9% for the three months ended September 30, 2018 from 28.2% for the three months ended September 30, 2017. The current quarter rate benefited from the decrease in the U.S. corporate income tax rate under the Tax Cuts and Jobs Act signed into law in December 2017, partially offset by tax expense of $251,000 related to completion of a state tax audit, while the prior year quarter benefited from the tax impact of our legal settlement with AGF.

Nine months ended September 30, 2018 compared to nine months ended September 30, 2017

Total Revenues. Total revenues decreased $3.7 million, or 4%, to $96.2 million for the nine months ended September 30, 2018 compared with $99.9 million for the nine months ended September 30, 2017. Asset-based advisory fees decreased $3.6 million, or 5%, related to lower average assets under management, and Trust fees decreased $1.3 million, or 6%, primarily due to the sale of the Omaha-based component of our Private Wealth business. These decreases were offset by a $1.6 million increase in performance-based advisory fees.

Employee Compensation and Benefits. Employee compensation and benefits costs decreased $2.0 million, or 4%, to $46.9 million for the nine months ended September 30, 2018 compared with $48.9 million for the nine months ended September 30, 2017. The decrease is due to reductions in compensation relating to the sale of the Omaha-based component of our Private Wealth business and short- and long-term incentive compensation as a result of lower asset-based revenues as compared to the prior year.

Information Technology. Information technology costs increased $1.3 million, or 23%, to $6.8 million for the nine months ended September 30, 2018 compared with $5.5 million for the nine months ended September 30, 2017 primarily due to implementation costs as we continue to invest in our technology infrastructure and increased research expenses.

Professional services. Professional services costs decreased $0.8 million, or 18%, to $3.7 million for the nine months ended September 30, 2018 compared with $4.5 million for the nine months ended September 30, 2017 primarily due to reduced legal fees in the current quarter as we settled the AGF lawsuit in the prior year quarter.

Legal Settlement. We recorded a net $4.0 million charge related to a legal settlement and associated insurance coverage during the third quarter of 2017. See further discussion of the settlement in Note 13 “Commitments and Contingencies” to our Condensed Consolidated Financial Statements included in Part I. Financial Information.

General & Administrative. General and administrative expenses decreased $2.2 million, or 26%, to $6.5 million for the nine months ended September 30, 2018 compared to $8.7 million for the nine months ended September 30, 2017 primarily due to a $0.8 million foreign currency transaction gain recorded in the first nine months of 2018 as compared to a $1.6 million foreign currency transaction loss recorded in the first nine months of 2017.

Gain on Sale of Operations. The nine months ended September 30, 2018 includes a $0.5 million gain on the sale of our Omaha-based component of our Private Wealth business.

Provision for Income Taxes. The effective tax rate decreased to 25.3% for the nine months ended September 30, 2018 from 29.1% for the nine months ended September 30, 2017. The current year-to-date rate benefited from the decrease in the U.S. corporate income tax rate under the Tax Cuts and Jobs Act signed into law in December 2017, partially offset by tax expense of $251,000 related to completion of a state tax audit, while the prior year benefited from the tax impact of our legal settlement with AGF and included a $1.0 million tax benefit related to the adoption of ASU 2016-09 Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting in the first quarter of 2017. Excluding this discrete tax benefit, our effective tax rate for the nine months ended September 30, 2017 would have been 33.0%. Prior to adoption of ASU 2016-09, excess tax benefits were recorded through Additional paid-in capital, with no impact to the effective tax rate.

Supplemental Financial Information

As supplemental information, we provide a non-U.S. generally accepted accounting principles (“non-GAAP”) performance measure that we refer to as Economic Earnings. We provide this measure in addition to, but not as a substitute for, net income reported on a U.S. generally accepted accounting principles (“GAAP”) basis. Our management and Board of Directors review Economic Earnings to evaluate our ongoing performance, allocate resources and review the dividend policy. We believe that this non-GAAP performance measure, while not a substitute for GAAP net income, is useful for management and investors when evaluating our underlying operating and financial performance and our available resources. We do not advocate that investors consider this non-GAAP measure without also considering financial information prepared in accordance with GAAP.

In calculating Economic Earnings, we add back to net income the non-cash expense associated with equity-based compensation awards of restricted stock, amortization of intangible assets and deferred taxes related to the tax-basis amortization of goodwill. Although depreciation on property and equipment is a non-cash expense, we do not add it back when calculating Economic Earnings because depreciation charges represent a decline in the value of the related assets that will ultimately require replacement.

The following tables provide a reconciliation of Net income to Economic Earnings (in thousands, except share and per share amounts):

	Three Months Ended September 30,		% Change
	2018	2017	
Net income	$5,368	$ 4,132	30 %
Add: Stock-based compensation expense	3,695	4,233	(13)
Add: Intangible amortization	419	469	(11)
Add: Tax benefit from goodwill amortization	59	156	(62)
Economic Earnings	$9,541	$ 8,990	6 %
Diluted weighted average shares outstanding	8,598,230	8,420,749	
Economic Earnings per share	$1.11	$ 1.07	

	Nine Months Ended September 30,		% Change
	2018	2017	
Net Income	$21,338	$ 17,092	25 %
Add: Stock-based compensation expense	11,658	12,298	(5)
Add: Intangible amortization	1,255	1,449	(13)
Add: Tax benefit from goodwill amortization	177	469	(62)
Economic Earnings	$34,428	$ 31,308	10 %
Diluted weighted average shares outstanding	8,561,918	8,350,926	
Economic Earnings per share	$4.02	$ 3.75	

Liquidity and Capital Resources

We fund our operations and cash requirements with cash generated from operating activities. We may also use cash from operations to pay dividends to our stockholders. As of September 30, 2018 and December 31, 2017, we had no debt. The changes in net cash provided by operating activities generally reflect the changes in earnings plus the effects of non-cash items and changes in working capital. Changes in working capital, especially accounts receivable and accounts payable, are generally the result of timing differences between collection of fees billed and payment of operating expenses.

During the nine months ended September 30, 2018, cash flow provided by operating activities, principally our investment advisory business, was $15.1 million. Cash flow provided by investing activities of $3.9 million during the nine months ended September 30, 2018 was primarily related to the sale of the Omaha-based component of our private wealth business, partially offset by our strategic investment in a private company. Cash flow used in financing activities of $24.3 million for the nine months ended September 30, 2018 reflected the payment of dividends, purchases of restricted stock returned for payment of taxes and purchases of treasury shares for our Canadian share award plan.

We had cash and short-term investments of $119.1 million as of September 30, 2018 and $105.6 million as of December 31, 2017. Cash and cash equivalents as of September 30, 2018 and December 31, 2017 included approximately $30 million and $33 million, respectively, of undistributed income from Westwood International. If these funds were needed for our U.S. operations, we would be required to accrue and pay incremental Canadian withholding taxes to repatriate a portion of these funds. Our current intention is to permanently reinvest the funds subject to withholding taxes outside of the U.S., and our current forecasts do not demonstrate a need to repatriate them to fund our U.S. operations. At September 30, 2018 and December 31, 2017, working capital aggregated $117.1 million and $106.6 million, respectively.

Westwood Trust must maintain cash and investments in an amount equal to the minimum restricted capital of $4.0 million, as required by the Texas Finance Code. Restricted capital is included in Investments in the accompanying Condensed Consolidated Balance Sheets. At September 30, 2018, Westwood Trust had approximately $16.8 million in excess of its minimum capital requirement.

Our future liquidity and capital requirements will depend upon numerous factors, including our results of operations, the timing and magnitude of capital expenditures or strategic initiatives, our dividend policy and other business and risk factors described under “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC. We believe that current cash and short-term investment balances plus cash generated from operations will be sufficient to meet both the operating and capital requirements of our ordinary business operations through at least the next twelve months. However, there can be no assurance that we will not require additional financing within this time frame. The failure to raise needed capital on attractive terms, if at all, could have a material adverse effect on our business, financial condition and results of operations.

Contractual Obligations

The following table summarizes our contractual obligations as of September 30, 2018 (in thousands):

	Payments due in:				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Purchase obligations[1]	$10,120	$3,032	$3,705	$1,759	$1,624
Operating lease obligations	$13,507	$1,908	$4,272	$3,501	$3,826

(1) A “purchase obligation” is defined as an agreement to purchase goods or services that is enforceable and legally binding and that specifies all significant terms, including (a) fixed or minimum quantities to be purchased; (b) fixed, minimum or variable price provisions; and (c) the approximate timing of the transaction. Our purchase obligations relate to obligations associated with implementing and operating new information technology platforms and outsourcing services. The above purchase obligations exclude agreements that are cancelable without significant penalty.

31

Critical and Significant Accounting Policies and Estimates

Effective January 1, 2018, we adopted ASU 2014-09, Revenue from Contracts with Customers (Topic 606). Refer to Note 9 “Revenue” in our Condensed Consolidated Financial Statements included in Part I, Item 1. “Financial Statements” of this Quarterly Report on Form 10-Q for a detailed description of the adoption of ASU 2014-09.

There have been no other significant changes in our critical or significant accounting policies and estimates since December 31, 2017. Information with respect to our critical accounting policies and estimates that we believe could have the most significant effect on our reported consolidated results and require difficult, subjective or complex judgment by management is described under “Critical Accounting Policies and Estimates” in Part II, Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

Accounting Developments

Refer to Note 2 “Summary of Significant Accounting Policies” in our Condensed Consolidated Financial Statements included in Part I, Item 1. “Financial Statements” of this Quarterly Report on Form 10-Q for a description of recently issued accounting guidance.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no significant changes in our Quantitative and Qualitative Disclosures about Market Risk from those previously reported in our Annual Report on Form 10-K for the year ended December 31, 2017.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports we file or submit under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), (1) is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and (2) is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, to allow timely decisions regarding required disclosure. An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on this evaluation, our management, including our Chief Executive Officer and our Chief Financial Officer, concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and is accumulated and communicated to management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Controls over Financial Reporting

For the quarter ended September 30, 2018, there were no changes in our internal controls over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS
None.
ITEM 1A. RISK FACTORS
We face a number of significant risks and uncertainties in our business, including those detailed under “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 and summarized in this report under “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” These risks and uncertainties may affect our current position and future prospects and should be considered carefully in evaluating us, including making an investment in our common stock.
ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
The following table displays information with respect to the treasury shares we purchased during the three months ended September 30, 2018:

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs (1)
Repurchase program (1)	—	$ —	—	$ 9,366,000
Canadian Plan (2)	—	$ —	—	CDN $ 3,478,000
Employee transactions (3)	—	$ —	—	—
July 1-31, 2018	118	$ 59.40	—	—

(1) On July 20, 2012, our Board of Directors authorized management to repurchase up to $10.0 million of our outstanding common stock on the open market or in privately negotiated transactions. In July 2016, Westwood's Board of Directors authorized an additional $5.0 million of repurchases under the share repurchase program. The share repurchase program has no expiration date and may be discontinued at any time by the Board of Directors.

(2) On April 18, 2013, our stockholders approved the Share Award Plan of Westwood Holdings Group, Inc. for Service Provided in Canada to its Subsidiaries (the “Canadian Plan”), which contemplates a trustee purchasing up to $10.0 million CDN of our outstanding common stock on the open market for the purpose of making share awards to our Canadian employees. The Canadian Plan has no expiration date and may be discontinued at any time by the Board of Directors.

(3) Consists of shares of common stock tendered by an employee at the market close price on the date of vesting in order to satisfy the employee’s minimum tax withholding obligations from vested restricted shares. We anticipate having additional shares tendered in subsequent periods for the same purpose.

ITEM 6. EXHIBITS

10.1*	Sixteenth Modification of Office Lease between Westwood Management Corp. and Crescent TC Investors LP, dated as of July 5, 2018
31.1*	Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a)
31.2*	Certification of Chief Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a)
32.1**	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2**	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.
** Furnished herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: October 24, 2018 WESTWOOD HOLDINGS GROUP, INC.

By: /s/ Brian O. Casey
Brian O. Casey
President and Chief Executive Officer

By: /s/ Tiffany B. Kice
Tiffany B. Kice
Chief Financial Officer and Treasurer