

WESTWOOD HOLDINGS GROUP INC  
Form 10-K  
February 28, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2012

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)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**75-2969997**  
(I.R.S. Employer  
Identification No.)

**200 Crescent Court, Suite 1200**

**Dallas, Texas 75201**  
(Address of principal executive offices)

**75201**  
(Zip Code)

**Registrant's telephone number, including area code: (214) 756-6900**

**SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:**

<b>Title of each class:</b>	<b>Name of each exchange on which registered:</b>
<b>Common Stock, par value \$0.01 per share</b>	<b>New York Stock Exchange</b>
<b>SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: None</b>	

Indicate by check mark if registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value on June 30, 2012 of the voting and non-voting common equity held by non-affiliates of the registrant was \$249,133,000. For purposes of this calculation, the registrant has assumed that stockholders that are not officers or directors of the registrant are

not affiliates of the registrant.

The number of shares of registrant's Common Stock, par value \$0.01 per share, outstanding as of February 24, 2013: 8,123,263.

**DOCUMENTS INCORPORATED BY REFERENCE**

Selected portions of the registrant's definitive Proxy Statement for the 2013 Annual Meeting of Stockholders are incorporated by reference into Part III hereof.

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**PART I**

**Item 1. Business.**

*Unless the context otherwise requires, the term we, us, our, Westwood, or Westwood Holdings Group when used in this Form 10-K ( Report ) and in the Annual Report to the Stockholders refers to Westwood Holdings Group, Inc., a Delaware corporation, and its consolidated subsidiaries and predecessors taken as a whole. This Report contains some forward-looking statements within the meaning of the federal securities laws. 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 those set forth under Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 1A. Risk Factors .*

**General**

We manage investment assets and provide services for our clients through our subsidiaries, Westwood Management Corp. ( Westwood Management ), Westwood Trust, and Westwood International Advisors Inc. ( Westwood International ). Westwood Management provides investment advisory services to corporate and public retirement plans, endowments and foundations, a family of mutual funds called the Westwood Funds™, other mutual funds, individuals and clients of Westwood Trust. We changed the name of our mutual fund family in early 2012 from the WHG Funds to the Westwood Funds™ as part of an effort to consolidate our branding strategies under the Westwood name, which has significant meaning to our firm. Westwood Trust provides trust and custodial services and participation in self-sponsored common trust funds to institutions and high net worth individuals. Westwood International, based in Toronto, Canada, was established in the second quarter of 2012 and provides global and emerging markets investment advisory services to institutional clients, the Westwood Funds™, other mutual funds and clients of Westwood Trust. Our revenues are generally derived from fees based on a percentage of assets under management. Westwood Management, Westwood Trust and Westwood International collectively managed assets valued at approximately \$14.2 billion at December 31, 2012.

The success of our business is very dependent on client relationships. We believe that, in addition to investment performance, client service is paramount in the asset management business. Accordingly, a major focus of our business strategy is to build strong relationships with clients to enhance our ability to anticipate their needs and satisfy their investment objectives. Our team approach is designed to deliver efficient, responsive service to our clients. Our success is dependent to a significant degree on investment performance and our ability to provide attentive client service.

We were incorporated under the laws of the State of Delaware on December 12, 2001. We are an independent public company and our common stock is listed on the New York Stock Exchange under the ticker symbol WHG. We are a holding company whose principal assets consist of the capital stock of Westwood Management, Westwood Trust and Westwood International.

One of several priorities on which we have focused since 2002 is the building of a foundation in terms of personnel and infrastructure to support a much larger business. We have also developed products that we expect to be desirable within our target institutional, private wealth and mutual fund markets. The costs of developing new products and building the organization can result in incurring expenses before significant offsetting revenues are realized. We believe that the business foundation and a range of appropriate products are now in place, and we have been taking these products in recent years to our served markets where they have been received with a high level of interest, thereby generating new revenue streams.

**Available Information**

We maintain a website at [www.westwoodgroup.com](http://www.westwoodgroup.com). Information contained on, or connected to, our website is not incorporated by reference into this Form 10-K and should not be considered part of this Report or any other filing that we make with the Securities and Exchange Commission ( SEC ). All of our filings with the SEC, including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on our website. Additionally, our Code of Business Conduct and Ethics, our

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Corporate Governance Guidelines and our Audit Committee, Compensation Committee and Governance/Nominating Committee Charters are available without charge on our website. Stockholders also may obtain print copies of these documents free of charge by submitting a written request to Mark A. Wallace, our Chief Financial Officer, at the address set forth in the front of this Report. The public can also obtain any document we file with the SEC at [www.sec.gov](http://www.sec.gov).

### *Advisory*

#### *General*

Our advisory business is comprised of Westwood Management and Westwood International.

Westwood Management provides investment advisory services to large institutions, including corporate retirement plans, public retirement plans, endowments and foundations. Institutional separate account minimums depend on the strategy offered but generally range from \$10 million to \$25 million. Westwood Management also provides advisory services to individuals and the Westwood Funds<sup>TM</sup> and subadvisory services to other mutual funds. Our overall investment philosophy was developed by our Founder and Chairman, Susan M. Byrne, and is implemented by a team of investment professionals under the leadership of our Chief Investment Officer, Mark Freeman. With respect to the bulk of assets under management we utilize a value investment style focused on achieving a superior long-term, risk-adjusted return by investing in companies with high levels of free cash flow, improving returns on equity, strengthening balance sheets and well positioned for growth but whose value is not fully recognized in the marketplace. This investment approach is designed to preserve capital during unfavorable periods and provide superior real returns over the long term. Our investment team members average investment experience of fifteen years and one third of the team has worked together at Westwood for more than six years. Team continuity and years of experience are among the critical elements required for successfully managing investments.

Westwood International provides investment advisory services to large institutions and subadvisory services to the National Bank Westwood Funds, which are mutual funds offered by National Bank of Canada. Westwood International has entered into a Memorandum of Understanding ( MOU ) with Westwood Management pursuant to which Westwood International is considered a participating affiliate of Westwood Management as that term is used in relief granted by the staff of the SEC allowing U.S. registered investment advisers to use portfolio management or research resources of advisory affiliates subject to the supervision of a registered adviser. Pursuant to the MOU, Westwood International professionals provide advisory and subadvisory services to certain Westwood Funds, common trust funds sponsored by Westwood Trust, and large U.S. institutions under the supervision of Westwood Management.

#### *Investment Strategies*

We offer a broad range of investment strategies allowing us to serve various client types and investment objectives. Approximately 37% of our assets under management are invested in our LargeCap Value strategy. The principal investment strategies currently managed by Westwood Management are as follows:

*LargeCap Value:* Investments in equity securities of approximately 40-60 well-seasoned companies with market capitalizations generally over \$5 billion. This portfolio is invested in companies where we expect that future profitability, driven by operational improvements, will exceed expectations reflected in current share prices.

*Dividend Growth:* Investments in equity securities of approximately 40-60 high quality companies with market capitalizations generally over \$1 billion. This portfolio is invested in companies of which at least 80% are paying dividends and whose prospects for dividend growth are strong. This strategy combines quantitative and fundamental research to create a diversified portfolio of companies we believe can create value for shareholders.

*SMidCap Plus+:* Investments in equity securities of approximately 45-65 companies with market capitalizations between \$2 billion and \$15 billion. Similar to our other value-oriented investment strategies, we seek to discover operational improvements driving earnings growth within small to mid-sized companies that can be purchased inexpensively.

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*SMidCap Value:* Investments in equity securities of approximately 45-60 companies with market capitalizations between \$500 million and \$10 billion. Similar to our other value-oriented investment strategies, we seek to discover operational improvements driving earnings growth within small to mid-size companies that can be purchased inexpensively. This strategy reached its asset capacity in 2010 and is now closed to new investors.

*SmallCap Value:* Investments in equity securities of approximately 50-70 companies with market capitalizations between \$100 million and \$2 billion. Similar to our other value-oriented investment strategies, we seek to invest in high quality companies whose earnings growth is driven by operational improvements not yet fully recognized by the market.

*AllCap Value:* Investments in equity securities of approximately 50-80 well-seasoned companies. The portfolio generally comprises our investment professionals' best ideas among companies with market capitalizations above \$100 million. Similar to our other value-oriented investment strategies, we seek to invest in companies across a broad range of market capitalizations where we expect that future profitability, driven by operational improvements, will be higher than expectations currently reflected in share prices.

*Balanced:* Investments in a combination of equity and fixed income securities, designed to provide both growth opportunities and income, while also emphasizing asset preservation in down markets. Westwood Management applies its expertise in dynamic asset allocation and security selection decisions in carrying out this balanced strategy approach.

*Income Opportunity:* Investments in dividend-paying common stocks, preferred stocks, convertible securities, master limited partnerships, royalty trusts, REITs and selected debt instruments. This portfolio's strategy focuses on companies with strong and improving cash flow sufficient to support a sustainable or rising income stream for investors. This strategy is targeted towards investors seeking current income, a competitive total return and low volatility through dividend-paying or interest-bearing securities.

*Master Limited Partnerships (MLPs):* Investments include MLPs (including limited partnerships and general partnerships) and other securities. Within these types of securities, the portfolio focuses on partnerships that exhibit higher distribution yields, stable and predictable cash flows, low correlations to other asset classes, and growth potential.

*Investment Grade Fixed Income:* Investments in high-grade, intermediate term corporate and government bonds. We seek to add value to client portfolios through yield curve positioning and investing in debt instruments with improving credit quality potential.

Each investment strategy consists of a portfolio of equity or fixed income securities selected by Westwood's portfolio teams and chosen to optimize long-term returns consistent with Westwood's investment philosophy. Our portfolio teams make decisions for Westwood Management investment strategies in accordance with the investment objectives and policies of those strategies, including determining when and which securities to purchase and sell.

We employ a value-oriented approach for our domestic equity investment strategies. The common thread that permeates these strategies is our disciplined approach to controlling risk and preserving client assets whenever possible. Our investment teams seek to invest in companies with high levels of free cash flow, improving returns on equity, and strengthening balance sheets that are well positioned for growth but whose value is not fully recognized in the marketplace. Through investments in companies that exhibit these characteristics, we seek to demonstrate consistently superior performance relative to our industry peers and relevant benchmark indices.

We believe we have established a track record of delivering competitive risk-adjusted returns for our clients. On an asset-weighted basis, more than 90 percent of our investment strategies have delivered above-benchmark performance and more than 95 percent have experienced below-benchmark volatility.

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Westwood International offers investment strategies that allow us to serve clients wishing to invest in strategies offering access to global and emerging markets. Over 70% of Westwood International's \$888 million of assets under management at December 31, 2012 is invested in our Emerging Markets strategies. The principal investment strategies currently managed by Westwood International are as follows:

*Emerging Markets:* This strategy invests in the common stocks of 70-90 companies that are located or have primary operations in emerging markets and have market capitalizations above USD \$500 million. The portfolio is invested in companies that we believe are sound businesses that are mispriced and can generate positive and sustainable earnings growth, thus generating economic profits growth over time.

*Emerging Markets Plus:* Similar to Emerging Markets, this strategy invests in the common stock of 50-70 companies that are located or have primary operations in emerging markets and have market capitalizations above USD \$1.5 billion. The portfolio is invested in companies that we believe are sound businesses that are mispriced and can generate positive and sustainable earnings growth, thus generating economic profits growth over time.

*Global Equity:* Invests in the common stock of 65-85 companies located throughout the world, with market capitalizations above USD \$1 billion. Similar to our Emerging Markets strategy, the portfolio invests in companies that we believe are sound businesses that are mispriced and can generate positive and sustainable earnings growth, thus generating economic profits growth over time.

*Global Dividend:* Invests in the common stock of 65-90 well-established companies around the world, with an emphasis on the sustainability and growth of dividends. This strategy seeks to invest in businesses that we believe are mispriced and can generate positive and sustainable earnings growth, thus achieving economic profits over time. The Global Dividend strategy searches for companies with liquidity, the ability to generate sustainable and positive economic profits, strong franchises with attractive valuations, earnings sustainability and an ability or prospective ability to pay dividends.

Our ability to grow assets under management is primarily dependent on our ability to generate competitive investment performance, our success in building strong relationships with investment consulting firms and other financial intermediaries as well as our ability to develop new client relationships. We continually seek to expand assets under management by growing our existing investment strategies as well as developing new ones. We intend to grow our investment strategies internally but may also consider acquiring new investment strategies from third parties, as discussed under *Growth Strategy* below. Our growth strategy provides clients with more investment opportunities and diversifies assets under management, thereby reducing risk in any one area of investment and increasing our competitive ability to attract new clients.

### *Advisory and Subadvisory Agreements*

Westwood Management and Westwood International manage client accounts under investment advisory and subadvisory agreements. As is typical in the asset management industry, such agreements are usually terminable upon short notice and provide for compensation based on the market value of client assets under management. Westwood's 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 previous quarter, or are based on a daily or monthly analysis of assets under management for the stated period. A few clients have contractual performance-based fee arrangements, which generate additional revenues if we outperform a specified index over a specific period of time. Revenue for performance-based fees is recorded at the end of the measurement period. Revenue from advance payments is deferred and recognized over the period that services are performed. Pursuant to these agreements, Westwood provides overall investment management services, including directing investments in conformity with client-established investment objectives and restrictions. Unless otherwise directed in writing by clients, Westwood has the authority to vote all proxies with respect to securities in client portfolios.

Westwood Management and Westwood International are parties to subadvisory agreements with other investment advisors under which they perform similar services as they do under advisory agreements. Our subadvisory fees are generally computed based upon the average daily assets under management and are payable on a monthly basis. As with our advisory agreements, these agreements are terminable upon short notice.



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Under our subadvisory agreement with Teton Advisors, Inc., an affiliate of GAMCO Investors, Inc., Westwood Management provides investment advisory services to the Teton Westwood Funds family of mutual funds. Based on SEC filings, we believe that GAMCO Investors, Inc. owned 10.2% of our common stock as of December 31, 2012. Westwood Management received subadvisory payments from Teton Advisors, Inc. totaling \$414,000, \$502,000 and \$573,000 for the twelve months ended December 31, 2012, 2011 and 2010, respectively.

While Westwood Management provides subadvisory services with respect to the Teton Westwood Funds family of mutual funds, Westwood Management provides investment advisory services directly to the Westwood Funds™ family of mutual funds, which includes the Westwood Income Opportunity Fund, the Westwood SMidCap Fund, the Westwood LargeCap Value Fund, the Westwood SmallCap Value Fund, the Westwood Dividend Growth Fund, the Westwood SMidCap Plus+ Fund, the Westwood Short Duration High Yield Fund, the Westwood Emerging Markets Fund, the Westwood Global Equity Fund and the Westwood Global Dividend Fund. The Westwood Short Duration High Yield Fund is subadvised by SKY Harbor Capital Management, LLC, a registered investment adviser based in Greenwich, Connecticut. As of December 31, 2012, the Westwood Funds™ had assets under management of \$1.6 billion.

Our four largest clients accounted for approximately 12.6% of our fee revenues for the year ended December 31, 2012. The loss of some or all of these large clients could have a material adverse effect on our business and our results of operations.

### ***Trust***

#### ***General***

Through Westwood Trust, we provide trust services and participation in Westwood Trust sponsored common trust funds to institutions and high net worth individuals and families generally having at least \$2 million in investable assets. Westwood Trust seeks to define and improve risk/return profiles of client investment portfolios by complementing or enhancing existing investment strategies. Westwood Trust provides back office services to clients, including tax reporting, distribution of income to beneficiaries, preparation of account statements and attending to the special needs of particular trusts, and also serves as trustee for tax and estate-planning purposes and for special needs trusts. Westwood Trust is chartered and regulated by the Texas Department of Banking.

Westwood Trust primarily provides services for employee benefit trusts and personal trusts. Employee benefit trusts include retirement plans of businesses to benefit their employees, including defined contribution plans, pensions and profit sharing plans. Westwood Trust may also be appointed as a trustee and may provide administrative support for these plans, as well as investment advisory and custodial services. Personal trusts are developed to achieve a number of different objectives and Westwood Trust acts as trustee to such trusts and assists them in developing tax-efficient trust portfolios. Fees charged by Westwood Trust are separately negotiated with each client and are typically based on assets under management.

#### ***Services***

Westwood Trust undertakes a fiduciary responsibility with regard to the management of each client's assets and utilizes a consultative asset allocation approach. This approach involves our examining the client's financial situation, including the client's current portfolio of investments, and advising the client on ways to enhance investment returns and strengthen its financial position. Westwood Trust also provides custodial services, safekeeping and accounting services.

#### ***Common Trust Funds***

Westwood Trust sponsors a number of common trust funds in which client assets are commingled to achieve economies of scale. Westwood Trust's common trust funds fall within two basic categories: personal trusts and employee benefit trusts. Westwood Trust sponsors common trust funds for most of the investment strategies managed by Westwood Management. Westwood Trust also engages third-party subadvisors for some common trust funds, such as our Domestic Growth Equity and High Yield Bond common trust funds.

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### *Enhanced Balanced Portfolios*

Westwood Trust is a strong proponent of asset class diversification and offers its clients the ability to diversify among many different asset classes. Westwood Trust Enhanced Balanced portfolios combine these asset classes into a customizable portfolio for clients seeking to maximize return for a given level of risk. Periodic adjustments are made to asset class weightings in Enhanced Balanced portfolios based on historical returns, risk and correlation data and our current capital markets outlook.

### *Distribution Channels*

We market our services through several distribution channels to expand the reach of our investment advisory services. These channels enable us to leverage the distribution infrastructures and capabilities of other financial services firms and intermediaries while focusing on our core competency of developing and managing investment strategies.

### *Institutional Investment Consultants*

Investment management consulting firms serve as gatekeepers to the majority of corporate retirement plans, public retirement plans, endowments and foundations, which represent Westwood's primary institutional target markets. Consultants provide guidance to their clients in setting asset allocation strategy, as well as creating investment policies. Consultants also make recommendations for investment firms they believe can best meet their client's investment objectives. We have established strong relationships with many national and regional investment consulting firms, which have contributed to our being considered and hired by their clients. Continuing to enhance existing consulting firm relationships, as well as forging new relationships, serves to increase the awareness of our services in both the consultant community and their served institutional client base.

### *Subadvisory Relationships*

Our subadvisory relationships allow us to extend the reach of our investment advisory services to clients of other investment companies with broad, established distribution capabilities. In subadvisory arrangements, our client is generally the investment company through which our services are offered to investors, typically via mutual fund offerings. The investment company that sponsors the mutual fund is responsible for relevant marketing, distribution, operational and accounting activities.

### *Managed Accounts*

Managed accounts are similar in some respects to subadvisory relationships in that a third-party financial institution, such as a brokerage firm or turnkey asset management program provider, handles distribution to the end client. The end client in a managed account is typically a high net worth individual or small institution. In these arrangements, the third-party financial institution is responsible to the end client for client service, operations and accounting.

### *Growth Strategy*

We believe that we have established a strong platform to support future growth, deriving our strength in large part from the experience and capabilities of our management team and skilled investment professionals. We believe that this focused, stable team has contributed significantly to our solid investment performance, superior client service and a growing array of investment strategies. We believe that opportunities for future growth may come from our ability to:

generate growth from new and existing clients and consultant relationships

attract and retain key employees

grow assets in our existing investment strategies

foster continued growth of the Westwood Trust platform

foster expanded distribution via mutual funds

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pursue strategic corporate development opportunities

pursue opportunities internationally through targeted sales and relationships with international distributors

continue to strengthen our brand name

develop or acquire new investment strategies

*Generate growth from new and existing clients and consultant relationships.* As our primary business objective, we intend to maintain and enhance existing relationships with clients and investment consultants by continuing to provide solid investment performance and attentive client service. We also intend to pursue growth through targeted sales and marketing efforts that emphasize our investment philosophy and performance and superior client service. New institutional client accounts are generally derived through investment consultants and we have developed productive long-term relationships with many national and regional investment consultants. We believe that the in-depth knowledge of our firm, our people and our processes embedded in our consultant and client relationships is a key factor when being considered for new client investment mandates.

*Attract and retain key employees.* In order to achieve our investment performance and client relationship objectives, we must be able to retain and attract talented professionals. We believe that we have created a workplace environment in which motivated, performance-driven, and client-oriented individuals thrive. As a public company, we are able to offer our employees a compensation program that includes strong equity incentives such that their success will be closely aligned with the success of our clients and stockholders. We believe that these factors are critical ingredients in maintaining a stable, client-focused environment that can support significant future growth.

*Grow assets in our existing investment strategies.* We believe our existing, seasoned investment strategies have significant capacity for additional assets. In order to further expand our offerings for current and prospective clients, we launched Westwood International in 2012, enabling us to offer four new equity strategies that focus on emerging and global markets: Emerging Markets, Emerging Markets Plus, Global Equity and Global Dividend. We believe these strategies are experiencing strong demand from investors and represent significant growth opportunities for us. Assets in our Income Opportunity strategy grew substantially in 2011 and 2012, exceeding \$1.7 billion at the end of 2012, as the strategy continued to receive strong interest from our private wealth and mutual fund channels as well as from additional institutional mandates. We have the team in place to support these investment strategies in our target institutional, private wealth and mutual fund markets. If we continue to deliver strong investment performance, we believe that demand for these strategies can provide meaningful growth in assets under management.

*Foster continued growth of the Westwood Trust platform.* Westwood Trust has experienced solid growth in serving small to medium-sized institutions as well as high net worth individuals and families. We anticipate continued interest from clients and prospects in our diversified, highly attentive service model. A significant percentage of new asset growth at Westwood Trust stems from referrals and gathering additional assets from existing clients. We believe that our Enhanced Balanced strategy, which offers diversified exposure to multiple asset classes in a tax-efficient, comprehensive solution for clients, provides opportunities for growth. Our 2010 acquisition of McCarthy Group Advisors, LLC in Omaha, Nebraska, enabled us to introduce Westwood Trust to a new market with attractive growth opportunities for our products and services.

*Foster expanded distribution via mutual funds.* We have ten funds in the Westwood Funds family: Westwood SMidCap (WHGMX), Westwood Income Opportunity (WHGIX), Westwood LargeCap Value (WHGLX), Westwood SmallCap Value (WHGSX), Westwood Dividend Growth (WHGDX), Westwood SMidCap Plus+ (WHGPX), Westwood Short Duration High Yield (WHGHX), Westwood Emerging Markets (WWEMX), Westwood Global Equity (WWGEX) and Westwood Global Dividend (WWGDX). We believe that providing investors access to our investment strategies via mutual funds is a key component to achieving asset growth in the defined contribution and retirement marketplaces as well as in the registered investment advisor distribution channel. With the exception of Westwood Short Duration High Yield, which is subadvised by SKY Harbor Capital Management, LLC, the Westwood Funds™ mirror our institutional strategies. The funds offer capped expense ratios and are available in an institutional share class for all funds. We also offer A shares for Westwood LargeCap Value (WWLAX), Westwood Income Opportunity (WWIAX) and Westwood Emerging Markets (WWEAX) in order to target No Transaction Fee ( NTF ) mutual fund supermarket platforms and the broker/dealer marketplace.

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*Pursue strategic corporate development opportunities.* We evaluate strategic corporate development opportunities carefully in order to augment organic growth. We may pursue various transactions, including acquisition of asset management firms, mutual funds or private wealth firms as well as hiring investment professionals or teams. We consider opportunities to enhance our existing operations, expand our range of investment strategies and services or further develop our distribution capabilities. By acquiring investment firms or by hiring investment professionals or teams that successfully manage investment strategies beyond our current expertise, we can attract new clients and provide existing clients with an even more diversified range of investment strategies. We may also consider forging alliances with other financial services firms to leverage our core competency of developing superior investment strategies in combination with alliance partners who could provide enhanced distribution capabilities or additional service offerings.

*Pursue opportunities internationally through targeted sales and relationships with international distributors.* We may consider forging alliances with international financial services firms or partners that could provide enhanced distribution capabilities and greater access to global customers.

*Continue to strengthen our brand name.* We believe that the strength of our brand name has been a key component to our long-term success in the investment industry and will be instrumental to our future success. We have developed our strong brand name largely through excellent performance coupled with high profile coverage in investment publications and electronic media. Several of our investment professionals, including Mark Freeman, David Spika, Ragen Stienke, Patricia Perez-Coutts and Thomas Pinto Basto have been visible in print and electronic media and we will continue to look for creative ways to strengthen our brand name and reputation in our target markets.

*Develop or acquire new investment strategies.* We continue to look for opportunities to expand our range of investment strategies that we offer to existing and prospective clients. We may consider internally-developed strategies that extend our existing investment process to new markets and may also consider externally acquired investment strategies. An expanded range of investment strategies offers us additional ways to serve our client base, more diversified revenue streams as well as asset and revenue growth opportunities.

### ***Competition***

We are subject to substantial and growing competition in all aspects of our business. Barriers to entry to the asset management business are relatively low, and we expect to face a growing number of competitors. Although no one company dominates the asset management industry, many companies are larger, better known and have greater resources than us.

Further, we compete with other asset management firms on the basis of investment strategies offered, the investment performance of those strategies both in absolute terms and relative to peer groups, quality of service, fees charged, the level and type of compensation offered to key employees, and the manner in which investment strategies are marketed. Many of our competitors offer more investment strategies and services than we do and have substantially greater assets under management.

We compete against numerous investment dealers, banks, insurance companies, mutual fund companies, exchange-traded funds, brokerage and investment firms, and others that sell equity funds, taxable income funds, tax-free investments and other investment products. In addition, the allocation of assets by many investors from active equity investment to index funds, fixed income or similar asset classes has enhanced the ability of firms offering non-equity asset classes and passive equity management to compete with us effectively. In summary, our competitive landscape is intense and dynamic and we may not be able to compete effectively in the future as an independent company.

Additionally, most prospective clients perform a thorough review of an investment manager's background, investment policies and performance before committing assets to that manager. In many cases, prospective clients invite a number of competing firms to make presentations. The process of obtaining a new client typically takes twelve to eighteen months from the time of the initial contact. While we have achieved success in competing successfully for new clients, it is a process to which we must dedicate significant resources over an extended period, with no certainty of success.

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### ***Regulation***

#### *Westwood Management*

Virtually all aspects of our business are subject to federal and state laws and regulations. These laws and regulations are primarily intended to protect investment advisory clients and stockholders of registered investment advisers. Under such laws and regulations, agencies that regulate investment advisers have broad administrative powers, including the power to limit, restrict or prohibit advisers from carrying on their business in the event that they fail to comply with such laws and regulations. Possible sanctions include suspension of individual employees, limitations on engaging in certain lines of business for specified periods of time, revocation of investment adviser and other registrations, censures and fines. We believe that we are in substantial compliance with all material laws and regulations.

Our business is subject to regulation at both federal and state levels by the SEC and other regulatory bodies. Westwood Management is registered with the SEC under the Investment Advisers Act of 1940 and under the laws of various states. As a registered investment adviser, Westwood Management is regulated and subject to examination by the SEC. The Investment Advisers Act imposes numerous obligations on registered investment advisers, including fiduciary duties, record keeping requirements, operational requirements, marketing requirements and disclosure obligations. Westwood Management also acts as adviser to the Westwood Funds<sup>TM</sup>, a family of mutual funds registered with the SEC under the Investment Company Act of 1940. As an adviser to a registered investment company, Westwood Management must comply with the Investment Company Act and related regulations. The Investment Company Act imposes numerous obligations on registered investment companies, including requirements relating to operations, fees charged, sales, accounting, record keeping, disclosure, governance and restrictions on transactions with affiliates. Under the rules and regulations of the SEC promulgated pursuant to the federal securities laws, we are subject to periodic SEC examinations. The SEC can institute proceedings and impose sanctions for violations of the Investment Advisers Act and the Investment Company Act, ranging from censure to termination of an investment adviser's registration. The failure of Westwood Management to comply with SEC requirements could have a material adverse effect on Westwood. We must also comply with anti-money laundering laws and regulations, including the USA PATRIOT Act of 2001, as subsequently amended and reauthorized. We believe that we are in substantial compliance with the requirements of the regulations under the Investment Advisers Act, the Investment Company Act and the USA PATRIOT Act.

#### *Westwood Trust*

Westwood Trust operates in a highly regulated environment and is subject to extensive supervision and examination. As a Texas chartered trust company, Westwood Trust is subject to the Texas Finance Code (the Finance Code), the rules and regulations promulgated under the Finance Code and supervision by the Texas Department of Banking. These laws are intended primarily for the protection of Westwood Trust's clients and creditors rather than for the benefit of investors. The Finance Code provides for and regulates a variety of matters, such as:

minimum capital maintenance requirements

restrictions on dividends

restrictions on investments of restricted capital

lending and borrowing limitations

prohibitions against engaging in certain activities

periodic fiduciary and information technology examinations by the office of the Texas Department of Banking Commissioner

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furnishing periodic financial statements to the Texas Department of Banking Commissioner

fiduciary record keeping requirements

prior regulatory approval for certain corporate events (such as mergers, sale/purchase of all or substantially all of the assets and transactions transferring control of a trust company)

The Finance Code also gives the Banking Commissioner broad regulatory powers (including penalties and civil and administrative actions) if the trust company violates certain provisions of the Finance Code or conservatorship or closure if Westwood Trust is determined to be in a hazardous condition (as defined by law). Westwood Trust's failure to comply with the Finance Code could have a material adverse effect on Westwood.

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Westwood Trust is limited by the Finance Code in the payment of dividends to undivided profits, which is described as that part of equity capital equal to the balance of net profits, income, gains, and losses since formation minus subsequent distributions to stockholders and transfers to surplus or capital under share dividends or appropriate board resolutions. At the discretion of its board of directors, Westwood Trust has made quarterly and special dividend payments to Westwood Holdings Group out of undivided profits.

### *Westwood International*

Westwood International is registered with both the Ontario Securities Commission ( OSC ) and the Autorité des marchés financiers ( AMF ) in Quebec.

The OSC is an independent Crown corporation that is responsible for regulating the capital markets in Ontario. Its statutory mandate is to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets. The OSC has rule-making and enforcement powers to help safeguard investors, deter misconduct and regulate participants involved in capital markets in Ontario. It regulates firms and individuals that sell securities and provide advice in Ontario, and also regulates public companies, investment funds and marketplaces, such as the Toronto Stock Exchange. The OSC's powers are granted under the Securities Act (Ontario) the Commodity Futures Act (Ontario) and certain provisions of the Business Corporations Act. It operates independently from government and is funded by fees charged to market participants. The OSC is accountable to the Ontario Legislature through the Minister of Finance.

The AMF is the entity mandated by the government of Québec to regulate the province's financial markets and provide assistance to consumers of financial products and services. Established on February 1, 2004 under an Act regarding the Autorité des marchés financiers, the AMF integrates the regulation of the Québec financial sector, notably in the areas of insurance, securities, deposit institutions (other than banks) and the distribution of financial products and services. The AMF's mission is to enforce the laws governing the regulation of the financial sector, notably in the areas of insurance, securities, deposit institutions (other than banks) and the distribution of financial products and services. Specifically, the AMF's mission is to:

provide assistance to consumers of financial products and services;

ensure that financial institutions and other regulated financial sector entities comply with applicable solvency and obligations imposed by law;

supervise activities connected with distribution of financial products and services;

supervise stock market and clearing house activities and monitor the securities market;

supervise derivatives markets, including derivatives exchanges and clearing houses and ensure that regulated entities and other derivatives market practitioners comply with obligations imposed by law; and

implement protection and compensation programs for consumers of financial products and services, and administer compensation funds set up by law.

Westwood International has entered into a Memorandum of Understanding ( MOU ) with Westwood Management pursuant to which Westwood International is considered a participating affiliate of Westwood Management. Subject to certain conditions, the SEC staff allows U.S. registered investment advisers to use portfolio management or research resources of advisory participating affiliates subject to the supervision of a registered adviser. Pursuant to the MOU, Westwood International professionals can provide advisory and subadvisory services to U.S clients subject to SEC rules and regulations and under the supervision of Westwood Management.

### *Employee Retirement Income Security Act of 1974*



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We are subject to the Employee Retirement Income Security Act of 1974, as amended ( ERISA ), and to the related regulations, insofar as we are a fiduciary under ERISA with respect to some clients. ERISA and applicable provisions of the Internal Revenue Code impose certain duties on fiduciaries under ERISA or on those that provide services to ERISA plan clients and prohibit certain transactions involving ERISA plan clients. Our failure to comply with these requirements could have a material adverse effect.

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Our employees may from time to time own shares of the funds we manage. Employee transactions in these funds and most other individual investments by employees require prior clearance and reporting of all securities transactions, and we restrict certain transactions to avoid the possibility of conflicts of interest.

***Employees***

At December 31, 2012, we had 96 full-time employees (85 based in the United States and 11 based in Canada). No employees are represented by a labor union and we believe our employee relations to be good.

***Segment Information***

For information about our operating segments, Advisory and Trust, please see Note 14 to the financial statements accompanying this Report.

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### **Item 1A. Risk Factors**

*We believe these represent the material risks currently facing our business. Our business, financial condition or results of operations could be materially adversely affected by these risks. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. You should carefully consider the risks described below before making an investment decision. You should also refer to the other information included or incorporated by reference in this Report, including our financial statements and related notes.*

#### **Poor investment performance of assets managed by us could adversely affect our results of operations.**

Because we compete with many asset management firms on the basis of the investment strategies we offer, our success is dependent to a significant extent on the investment performance of the assets that we manage. Because our revenue is primarily generated from fees derived as a percentage of assets under management, poor performance tends to result in the loss or reduction of client accounts, which correspondingly decreases revenues. Underperformance relative to peer groups for our various investment strategies could adversely affect our results of operations, especially if such underperformance continues for a lengthy period of time.

Recently, we have experienced some client outflows that we believe may have resulted in part from the underperformance of our LargeCap Value strategy, which invests in equity securities of companies with large market capitalizations and which represents about 37% of our assets under management. Our LargeCap Value strategy underperformed its Russell 1000 Value benchmark index and ranked below the median return of its peer group in 2010 and 2011. Our LargeCap Value strategy underperformed relative to its Russell 1000 Value benchmark, but ranked above the median return of its peer group, in 2012. While we believe this recent underperformance has resulted in some increased client outflows, many factors are involved in client investment and allocation decisions and we cannot specifically quantify the amount of outflows resulting from this recent underperformance.

#### **Some key employees are considered critical to our success, and our inability to attract and retain key employees could compromise our future success.**

We believe that our future success will depend to a significant extent upon the services of our certain key employees, particularly Brian O. Casey, President and Chief Executive Officer, Mark Freeman, Chief Investment Officer, and Patricia Perez-Coutts, Senior Portfolio Manager. As with other asset management businesses, our future performance depends to a significant degree upon the continued contributions of these and other key officers, investment professionals, as well as marketing, client service and management personnel. There is substantial competition for skilled personnel and the loss of key employees or our failure to attract, retain and motivate qualified personnel, could negatively impact our business, financial condition, results of operations and future prospects.

#### **Our revenues are dependent upon the performance of the securities markets and negative performance of the securities markets could reduce our revenues.**

Our results of operations are affected by many economic factors, including the performance of the securities markets. Negative performance within the securities markets or short-term volatility within the securities markets could result in investors withdrawing assets, decreasing their rates of investment or shifting assets to cash or other asset classes or strategies that we do not manage, all of which could reduce our revenues. Because most of our revenues are based on the value of assets under management, a decline in the value of those assets would also adversely affect our revenues. In addition, in periods of slowing growth or declining revenues, profits and profit margins are adversely affected because certain expenses remain relatively fixed.

In particular, a significant portion of our assets under management is invested in equity securities of companies with large market capitalizations. As a consequence, we are particularly susceptible to the volatility associated with changes in the market for large capitalization stocks. Due to this concentration, any change or reduction in such markets, including a shift of our clients' and potential clients' preference from investments in equity securities of large capitalization stocks to other equity or fixed income securities could have a significant negative impact on our revenues and results of operations. This negative impact could occur due to the depreciation in value of our assets under management, the election by clients to select other firms to manage their assets or the election by clients to allocate assets away from asset classes that we manage. Any of these events would result in decreased assets under management and therefore reduced revenues and a decline in results of operations.

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**If we are unable to realize benefits from the costs we have incurred and are continuing to incur to develop new investment strategies and otherwise broaden our capabilities, our growth opportunities may be adversely affected.**

We have incurred significant costs to develop new investment strategies, including Emerging Markets, Global Equity, Global Dividend, SmallCap Value, AllCap Value, Global Strategic Diversification, an MLP portfolio and SMidCap Plus+, to launch new mutual funds under the Westwood Funds™ name and to upgrade our business infrastructure and we expect to continue to incur significant costs to develop and launch new investment strategies. Some costs associated with these improvements and new investment strategies will continue to be incurred in future periods and are relatively fixed. We may not realize the benefits of these investments and, if unable to do so, our results of operations and growth opportunities may be adversely affected.

**Expansion into international markets and introduction of new products and services increases our operational, regulatory and other risks.**

We have expanded our product offerings and international business activities over the last year with the establishment of Westwood International and its global and emerging markets strategies. As a result, we face increased operational, regulatory, compliance, reputation and foreign exchange rate risks. The failure of our compliance and internal control systems to properly mitigate such additional risks, or of our operating infrastructure to support international activities, could result in operational failures and actions by regulatory agencies, which could have a material adverse effect on our business.

**Due to the substantial cost and time required to introduce new investment strategies in our industry, we may not be able to successfully introduce new investment strategies in a timely manner, or at all.**

The development of new investment strategies, whether through acquisition or internal development, requires a substantial amount of time and significant financial resources, including expenses related to compensation, sales and marketing, information technology, legal counsel and other professional services. Our ability to market and sell a new investment strategy depends on our financial resources, the investment performance of the specific strategy, the timing of the offering and our marketing strategies. Once an investment strategy is developed, we must effectively market the strategy to existing and prospective clients. Our ability to sell new investment strategies to existing and prospective clients depends on our ability to meet or exceed the performance of our competitors offering the same or a similar strategy. We may not be able to manage the assets within a given investment strategy profitably. Moreover, it may take years before we are able to produce the level of results that will enable us to attract clients. If we are unable to realize the benefits of the costs and expenses incurred in developing new investment strategies, we may experience losses as a result of our management of these investment strategies, and our ability to introduce further new investment strategies and compete in our industry may be hampered.

**Our business is dependent on investment advisory, subadvisory and trust agreements that are subject to termination or non-renewal. As a result, we could lose any of our clients on very short notice.**

Substantially all of our revenues are derived pursuant to investment advisory, subadvisory and trust agreements with our clients. In general, either party may terminate these agreements upon 30 days' notice. Any termination of, or failure to renew, a material number of these agreements could have a material adverse impact on us, particularly because many of our costs are relatively fixed.

**A small number of clients account for a substantial portion of our business. As such, the reduction or loss of business with any of these clients could have a material adverse effect on our business, financial condition and results of operations.**

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Our four largest clients accounted for approximately 12.6% of fee revenues for the year ended December 31, 2012. We are dependent to a significant degree on our ability to maintain our relationships with these clients. There can be no assurance that we will be successful in maintaining existing client relationships, securing additional clients or achieving the superior investment performance necessary to earn performance-based advisory fees. Any failure by us to retain one or more of these large clients or establish profitable relationships with additional clients could have a material adverse effect on our business, financial condition and results of operations.

### **Competitive fee pressures could reduce revenues and profit margins.**

The investment management business is highly competitive and has relatively low barriers to entry. To the extent we have to compete on the basis of price, we may not be able to maintain our current fee structure. Although our investment management fees vary from product to product, we have competed primarily on the performance of our products and client service rather than on the level of our investment management fees relative to our competitors. In recent years there has been a trend toward lower fees in the investment management industry. In order to maintain our fee structure in a competitive environment, we must be able to continue to provide clients with investment returns and service that make investors willing to pay our fees. We cannot be assured that we will succeed in providing investment returns and service that will allow us to maintain our current fee structure. Fee reductions on existing or future new business could have an adverse effect on our profit margins and results of operations.

### **Performance fees could have a significant effect on our revenues and results of operations.**

We have performance fee agreements with a few clients, which pay us a fee if we outperform a specified index over predetermined periods of time. We may not be able to outperform such indexes and the failure to do so would cause us to earn none or only part of those potential revenues, which would have a material adverse effect on our revenues and results of operations. Our revenues from performance-based fees could fluctuate significantly from one measurement period to the next, depending on how we perform relative to the indexes specified in these agreements. For example, we earned performance fees of \$1.3 million in 2012 and \$1.0 million in 2011, but did not earn a performance fee in 2010.

### **Any event that negatively affects the asset management industry in general could have a material adverse effect on us.**

Any event affecting the asset management industry that results in a general decrease in assets under management or a significant general decline in the number of advisory clients or accounts could negatively impact our revenues. Our future growth and success depends in part upon the growth of the asset management industry.

### **Our business is subject to extensive regulation with attendant costs of compliance and serious consequences for violations.**

Virtually all aspects of our business are subject to laws and regulations, including the Investment Advisers Act, the Investment Company Act, and anti-money laundering laws. These laws and regulations generally grant regulatory agencies broad administrative powers, including the power to limit or restrict us from operating our business as well as the powers to place us under conservatorship or closure in the event we fail to comply with such laws and regulations. Violations of such laws or regulations could subject us or our employees to disciplinary proceedings and civil or criminal liability, including revocation of licenses, censures, fines or temporary suspensions, permanent barring from the conduct of business, conservatorship, or closure. Any such proceeding or liability could have a material adverse effect upon our business, financial condition, results of operations and business prospects. Due to the extensive regulations and laws to which we are subject, our management devotes substantial time and effort to legal and regulatory compliance issues.

In recent years, regulators have shown an increasing interest in oversight of the financial services industry. Some newly adopted regulations are focused directly on the investment management industry, while others are more broadly focused but affect our industry as well. The Dodd-Frank Act of 2010 significantly increased and revised the federal rules and regulations governing the financial services industry and, in addition to other regulations, has generally resulted in increased compliance and administrative burdens for us. For example, the SEC's recent adoption of Form PF and revisions to Form ADV impose additional reporting requirements for SEC registered investment advisors, including us. Additionally, ERISA Section 408(b)(2) and related regulations require additional information to be provided to ERISA-governed retirement plans. While we believe that changes in laws, rules and regulations, including the ones discussed above, have increased our administrative and compliance costs, we are not able to quantify the amount of increased costs attributable to those changes.

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In addition, the regulatory environment in which we operate is subject to change. We may be adversely affected as a result of new or revised legislation or regulations or by changes in the interpretation or enforcement of existing laws and regulations. See Item 1. Business Regulation.

### **Misuse of assets and information in the possession of our investment professionals and employees could result in costly litigation and liability for us and our clients.**

Our investment professionals handle significant amounts of assets along with financial and personal information for our clients. We have implemented a system of controls to minimize the risk of a fraudulent use of assets and information, however our controls may not be sufficiently adequate to prevent such fraudulent actions by portfolio managers or employees. If our controls are ineffective, we could be subject to costly litigation, which could consume financial resources, distract management and result in regulatory sanctions. Such fraudulent actions could also adversely affect clients, causing them to seek redress.

### **Acquisitions involve inherent risks that could compromise the success of the combined business and dilute the holdings of current stockholders.**

As part of our long-term business strategy, we may pursue corporate development transactions including the acquisition of asset management firms, mutual funds, private wealth firms, investment professionals or teams. See Item 1. Business Growth Strategy. If we are incorrect when assessing the value, strengths, weaknesses, liabilities and potential profitability of such transactions, or if we fail to integrate the acquired businesses or individuals, the success of the combined business could be compromised. Any business acquisitions are subject to the risks commonly associated with such transactions including, among others, potential exposure to unknown liabilities of acquired companies and to acquisition costs and expenses, the difficulty and expense of integrating the operations and personnel of the acquired companies, potential disruptions to the business of the combined company and potential diversion of management's time and attention, the impairment of relationships with and the possible loss of key employees and clients as a result of changes in management, potential litigation or other legal risks, potential write-downs related to goodwill impairments in connection with acquisitions, and dilution to the stockholders of the combined company if the acquisition is made for stock of the combined company. In addition, investment strategies, technologies or businesses of acquired companies may not be effectively assimilated into our business or may have a negative effect on the combined company's revenues or earnings. The combined company may also incur significant expense to complete acquisitions and support acquired investment strategies and businesses. Further, any such acquisitions may be funded with cash, debt or equity, which could have the effect of diluting the holdings or limiting the rights of stockholders. Finally, we may not be successful in identifying attractive acquisition candidates or completing acquisitions on favorable terms.

### **Our acquisitions were forecasted to add revenues, expenses and earnings to our business. The failure to realize these revenues and earnings could adversely impact our results of operations.**