

VIRTUS INVESTMENT PARTNERS, INC.

Form 10-Q

November 07, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

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: 001-10994

VIRTUS INVESTMENT PARTNERS, INC.

(Exact name of registrant as specified in its charter)

Delaware

95-4191764

(State or other jurisdiction of (I.R.S. Employer incorporation or organization) Identification No.)

100 Pearl St., Hartford, CT 06103

(Address of principal executive offices) (Zip Code)

(800) 248-7971

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

The number of shares outstanding of the registrant's common stock was 5,888,533 as of October 31, 2016.

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| <br>“We,” “us,” “our,” the “Company” and “Virtus” as used in this Quarterly Report on Form 10-Q, refer to Virtus Investment Partners, Inc., a Delaware corporation, and its subsidiaries. |           |

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

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Virtus Investment Partners, Inc.  
Condensed Consolidated Balance Sheets  
(Unaudited)

|   | September 30,<br>2016 | December 31,<br>2015 |
|---|-----------------------|----------------------|
| (\$ in thousands, except share data)  |                       |                      |
| Assets:   |                       |                      |
| Cash and cash equivalents   | \$ 165,421            | \$ 87,574            |
| Investments   | 95,174                | 56,738               |
| Accounts receivable, net  | 36,867                | 38,757               |
| Assets of consolidated sponsored investment products  |                       |                      |
| Cash of consolidated sponsored investment products  | 1,149                 | 1,513                |
| Cash pledged or on deposit of consolidated sponsored investment products  | 944                   | 10,353               |
| Investments of consolidated sponsored investment products   | 137,140               | 323,335              |
| Other assets of consolidated sponsored investment products  | 2,560                 | 8,549                |
| Assets of consolidated investment product   |                       |                      |
| Cash equivalents of consolidated investment product   | 12,703                | 8,297                |
| Investments of consolidated investment product  | 360,210               | 199,485              |
| Other assets of consolidated investment product   | 4,628                 | 1,467                |
| Furniture, equipment and leasehold improvements, net  | 7,864                 | 9,116                |
| Intangible assets, net  | 39,030                | 40,887               |
| Goodwill  | 6,788                 | 6,701                |
| Deferred taxes, net   | 44,623                | 54,143               |
| Other assets  | 14,463                | 12,814               |
| Total assets  | \$ 929,564            | \$ 859,729           |
| Liabilities and Equity  |                       |                      |
| Liabilities:  |                       |                      |
| Accrued compensation and benefits   | \$ 37,813             | \$ 49,617            |
| Accounts payable and accrued liabilities  | 21,429                | 23,036               |
| Dividends payable   | 4,117                 | 4,233                |
| Other liabilities   | 13,619                | 13,051               |
| Liabilities of consolidated sponsored investment products   | 2,930                 | 15,387               |
| Liabilities of consolidated investment product  |                       |                      |
| Debt of consolidated investment product   | —                     | 152,597              |
| Notes payable of consolidated investment product  | 323,852               | —                    |
| Securities purchased payable and other liabilities of consolidated investment product   | 25,704                | 18,487               |
| Total liabilities   | 429,464               | 276,408              |
| Commitments and Contingencies (Note 13)   |                       |                      |
| Redeemable noncontrolling interests   | 30,301                | 73,864               |
| Equity:   |                       |                      |
| Equity attributable to stockholders:  |                       |                      |
| Common stock, \$0.01 par value, 1,000,000,000 shares authorized; 9,112,052 shares issued and 7,609,753 shares outstanding at September 30, 2016 and 9,613,088 shares issued and 8,398,944 shares outstanding at December 31, 2015 | 91                    | 96                   |
| Additional paid-in capital  | 1,089,350             | 1,140,875            |
| Accumulated deficit   | (436,705)             | (472,614)            |
| Accumulated other comprehensive loss  | (235)                 | (1,034)              |
| Treasury stock, at cost, 1,502,299 and 1,214,144 shares at September 30, 2016 and December 31, 2015, respectively   | (182,702)             | (157,699)            |

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|   |            |            |
|---|------------|------------|
| Total equity attributable to stockholders | 469,799    | 509,624    |
| Noncontrolling interests                  | —          | (167 )     |
| Total equity                              | 469,799    | 509,457    |
| Total liabilities and equity              | \$ 929,564 | \$ 859,729 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Virtus Investment Partners, Inc.  
Condensed Consolidated Statements of Operations  
(Unaudited)

|   | Three Months<br>Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|--|-----------|------------------------------------|-----------|
|   | 2016                                   | 2015      | 2016                               | 2015      |
| (\$ in thousands, except per share data)  |  |           |                                    |           |
| Revenues  |  |           |                                    |           |
| Investment management fees  | \$60,398                               | \$64,891  | \$176,234                          | \$204,254 |
| Distribution and service fees   | 12,116                                 | 15,587    | 36,761                             | 52,820    |
| Administration and transfer agent fees  | 9,588                                  | 11,614    | 29,085                             | 37,233    |
| Other income and fees   | 222                                    | 283       | 624                                | 1,555     |
| Total revenues  | 82,324                                 | 92,375    | 242,704                            | 295,862   |
| Operating Expenses  |  |           |                                    |           |
| Employment expenses   | 33,142                                 | 33,504    | 102,184                            | 102,719   |
| Distribution and other asset-based expenses   | 17,380                                 | 21,717    | 52,913                             | 69,900    |
| Other operating expenses  | 11,392                                 | 11,165    | 34,614                             | 51,403    |
| Other operating expenses of consolidated sponsored investment products                                | 611                                    | 1,120     | 2,521                              | 2,895     |
| Other operating expenses of consolidated investment product   | 24                                     | —         | 3,921                              | —         |
| Restructuring and severance   | 1,879                                  | —         | 4,270                              | —         |
| Depreciation and other amortization   | 754                                    | 910       | 2,392                              | 2,562     |
| Amortization expense  | 604                                    | 837       | 1,858                              | 2,511     |
| Total operating expenses  | 65,786                                 | 69,253    | 204,673                            | 231,990   |
| Operating Income  | 16,538                                 | 23,122    | 38,031                             | 63,872    |
| Other Income (Expense)  |  |           |                                    |           |
| Realized and unrealized gain (loss) on investments, net   | 961                                    | (2,082 )  | 3,584                              | (1,194 )  |
| Realized and unrealized gain (loss) on investments of consolidated sponsored investment products, net | 3,536                                  | (17,619 ) | 6,928                              | (18,271 ) |
| Realized and unrealized gain (loss) of consolidated investment product, net                           | 144                                    | (721 )    | 2,960                              | (721 )    |
| Other income, net   | 250                                    | 141       | 463                                | 823       |
| Total other income (expense), net   | 4,891                                  | (20,281 ) | 13,935                             | (19,363 ) |
| Interest Income (Expense)   |  |           |                                    |           |
| Interest expense  | (128 )                                 | (138 )    | (389 )                             | (382 )    |
| Interest and dividend income  | 221                                    | 324       | 1,113                              | 906       |
| Interest and dividend income of investments of consolidated sponsored investment products             | 1,364                                  | 2,898     | 6,021                              | 8,320     |
| Interest expense of consolidated investment product   | (3,788 )                               | (1 )      | (10,188 )                          | (1 )      |
| Interest income of consolidated investment product  | 4,047                                  | 42        | 8,835                              | 42        |
| Total interest income, net  | 1,716                                  | 3,125     | 5,392                              | 8,885     |
| Income Before Income Taxes  | 23,145                                 | 5,966     | 57,358                             | 53,394    |
| Income tax expense  | 6,869                                  | 9,669     | 20,512                             | 28,360    |
| Net Income (Loss)   | 16,276                                 | (3,703 )  | 36,846                             | 25,034    |
| Noncontrolling interests  | (651 )                                 | 3,054     | (770 )                             | 3,436     |
| Net Income (Loss) Attributable to Common Stockholders   | \$15,625                               | \$(649 )  | \$36,076                           | \$28,470  |
| Earnings (Loss) per Share—Basic   | \$2.04                                 | \$(0.07 ) | \$4.47                             | \$3.21    |
| Earnings (Loss) per Share—Diluted   | \$1.99                                 | \$(0.07 ) | \$4.39                             | \$3.15    |
| Cash Dividends Declared per Share   | \$0.45                                 | \$0.45    | \$1.35                             | \$1.35    |

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|  |       |       |       |       |
|--|-------|-------|-------|-------|
| Weighted Average Shares Outstanding—Basic (in thousands)   | 7,676 | 8,775 | 8,062 | 8,876 |
| Weighted Average Shares Outstanding—Diluted (in thousands) | 7,854 | 8,775 | 8,223 | 9,039 |

The accompanying notes are an integral part of these condensed consolidated financial statements.



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Virtus Investment Partners, Inc.  
 Condensed Consolidated Statements of Comprehensive Income  
 (Unaudited)

|   | Three Months<br>Ended<br>September 30, |           | Nine Months<br>Ended September<br>30, |          |
|---|--|-----------|---------------------------------------|----------|
|   | 2016                                   | 2015      | 2016                                  | 2015     |
| (\$ in thousands)   |  |           |                                       |          |
| Net Income (Loss)   | \$16,276                               | \$(3,703) | \$36,846                              | \$25,034 |
| Other comprehensive income (loss), net of tax:  |  |           |                                       |          |
| Foreign currency translation adjustment, net of tax of (\$28) for the three months ended September 30, 2015 and (\$348) and \$167 for the nine months ended September 30, 2016 and 2015, respectively   | —                                      | 49        | 569                                   | (271)    |
| Unrealized (loss) gain on available-for-sale securities, net of tax of \$31 and \$35 for the three months ended September 30, 2016 and 2015, respectively and (\$140) and \$26 for the nine months ended September 30, 2016 and 2015 respectively | (50)                                   | (290)     | 230                                   | (389)    |
| Other comprehensive (loss) income   | (50)                                   | (241)     | 799                                   | (660)    |
| Comprehensive income (loss)   | 16,226                                 | (3,944)   | 37,645                                | 24,374   |
| Comprehensive (income) loss attributable to noncontrolling interests  | (651)                                  | 3,054     | (770)                                 | 3,436    |
| Comprehensive Income (Loss) Attributable to Common Stockholders   | \$15,575                               | \$(890)   | \$36,875                              | \$27,810 |
| The accompanying notes are an integral part of these condensed consolidated financial statements.   |  |           |                                       |          |

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## Virtus Investment Partners, Inc.

## Condensed Consolidated Statements of Cash Flows

(Unaudited)

Nine Months Ended  
September 30,  
2016      2015

(\$ in thousands)

## Cash Flows from Operating Activities:

|  |           |          |
|--|-----------|----------|
| Net income   | \$36,846  | \$25,034 |
| Adjustments to reconcile net income to net cash provided by operating activities:                        |           |          |
| Depreciation expense, intangible asset and other amortization  | 4,430     | 5,241    |
| Stock-based compensation   | 9,064     | 9,166    |
| Excess tax benefits from stock-based compensation  | (192)     | (1,515)  |
| Amortization of discount on notes payable of consolidated investment product                             | 3,719     | —        |
| Amortization of deferred commissions   | 1,900     | 6,903    |
| Payments of deferred commissions   | (1,405)   | (2,585)  |
| Equity in earnings of equity method investments  | (444)     | (804)    |
| Realized gain on sale of equity method investment  | (2,883)   | —        |
| Realized and unrealized (gains) losses on trading securities, net  | (700)     | 1,490    |
| Realized and unrealized (gains) losses on investments of consolidated sponsored investment products, net | (7,815)   | 21,611   |
| Realized and unrealized (gains) losses of consolidated investment product, net                           | (2,289)   | 721      |
| Sales of trading securities, net   | 10,811    | 9,945    |
| Sales (purchases) of investments by consolidated sponsored investment products, net                      | 97,569    | (96,222) |
| (Purchases) sales of securities sold short by consolidated sponsored investment products, net            | (4,648)   | 3,534    |
| Purchases of investments by consolidated investment product, net   | (154,139) | (29,085) |
| Deferred taxes, net  | 9,032     | 655      |
| Changes in operating assets and liabilities:   |           |          |
| Cash pledged or on deposit of consolidated sponsored investment products                                 | 9,644     | (6,912)  |
| Accounts receivable, net and other assets  | (297)     | 4,101    |
| Other assets of consolidated sponsored investment products   | (478)     | (1,649)  |
| Other assets of consolidated investment product  | (415)     | 43       |
| Accrued compensation and benefits, accounts payable, accrued liabilities and other liabilities           | (12,893)  | (8,102)  |
| Liabilities of consolidated sponsored investment products  | 426       | 1,499    |
| Liabilities of consolidated investment product, net  | 4,027     | (20)     |
| Net cash used in operating activities  | (1,130)   | (56,951) |
| Cash Flows from Investing Activities:  |           |          |
| Capital expenditures   | (1,461)   | (3,723)  |
| Proceeds from sale of equity method investment   | 8,621     | —        |
| Change in cash and cash equivalents of consolidated sponsored investment products due to deconsolidation | 103       | —        |
| Equity method investment contributions   | (2,471)   | (1,617)  |
| Cash acquired in business combination  | —         | 89       |
| Purchases of available-for-sale securities   | (183)     | (168)    |
| Net cash provided by (used in) investing activities  | 4,609     | (5,419)  |
| Cash Flows from Financing Activities:  |           |          |
| Borrowings of proceeds from short sales by consolidated sponsored investment products                    | —         | 831      |

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|  |             |            |
|--|-------------|------------|
| Payments on borrowings by consolidated sponsored investment products                                     | (3,557 )    | (164 )     |
| Repayment of debt of consolidated investment product   | (152,597 )  | —          |
| Borrowings of debt of consolidated investment product  | —           | 9,140      |
| Proceeds from issuance of notes payable by consolidated investment product                               | 316,280     | —          |
| Dividends paid   | (11,119 )   | (12,146 )  |
| Repurchases of common shares   | (72,216 )   | (45,000 )  |
| Proceeds from exercise of stock options  | 428         | 70         |
| Taxes paid related to net share settlement of restricted stock units                                     | (1,518 )    | (5,080 )   |
| Excess tax benefits from stock-based compensation  | 192         | 1,515      |
| Payment of deferred financing costs  | (1,442 )    | —          |
| Contributions of noncontrolling interests, net   | 3,959       | 38,747     |
| Net cash provided by (used in) financing activities  | 78,410      | (12,087 )  |
| Net increase (decrease) in cash and cash equivalents   | 81,889      | (74,457 )  |
| Cash and cash equivalents, beginning of period   | 97,384      | 203,304    |
| Cash and Cash Equivalents, End of Period   | \$ 179,273  | \$ 128,847 |
| Non-Cash Investing Activities:   |             |            |
| Change in accrual for capital expenditures   | \$ 140      | \$(313 )   |
| Investment in acquired business  | —           | 4,800      |
| Non-Cash Financing Activities:   |             |            |
| Decrease to noncontrolling interest due to deconsolidation of consolidated sponsored investment products | \$(48,292 ) | \$(8,640 ) |
| Dividends payable  | \$ 3,424    | \$ 4,258   |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Virtus Investment Partners, Inc.  
Condensed Consolidated Statements of Changes in Equity  
(Unaudited)

| (\$ in thousands<br>except per share<br>data)                                | Common Stock |           |                                  | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Treasury Stock |             | Total<br>Attributed<br>To<br>Stockholders | Non-<br>controlling<br>Interests | Total<br>Equity |
|--|--------------|-----------|----------------------------------|------------------------|---|----------------|-------------|---|----------------------------------|-----------------|
|  | Shares       | Par Value | Additional<br>Paid-in<br>Capital |                        |   | Shares         | Amount      |   |                                  |                 |
| Balances at<br>December 31,<br>2014  | 8,975,833    | \$96      | \$1,148,908                      | \$(507,521)            | \$(242)   | 575,441        | \$(77,699)  | \$563,542                                 | \$(190)                          | \$563,352       |
| Net income (loss)  | —            | —         | —                                | 28,470                 | —   | —              | —           | 28,470                                    | (106)                            | 28,364          |
| Net unrealized<br>loss on securities<br>available-for-sale                   | —            | —         | —                                | —                      | (389)   | —              | —           | (389)                                     | —                                | (389)           |
| Foreign currency<br>translation<br>adjustments                               | —            | —         | —                                | —                      | (271)   | —              | —           | (271)                                     | —                                | (271)           |
| Activity of<br>noncontrolling<br>interests, net                              | —            | —         | —                                | —                      | —   | —              | —           | —   | —                                | —               |
| Cash dividends<br>declared (\$1.35<br>per common<br>share)                   | —            | —         | (12,136)                         | —                      | —   | —              | —           | (12,136)                                  | —                                | (12,136)        |
| Repurchases of<br>common shares  | (368,468)    | —         | —                                | —                      | —   | 368,468        | (45,000)    | (45,000)                                  | —                                | (45,000)        |
| Issuance of<br>common shares<br>related to<br>employee stock<br>transactions | 60,301       | —         | 796                              | —                      | —   | —              | —           | 796                                       | —                                | 796             |
| Taxes paid on<br>stock-based<br>compensation                                 | —            | —         | (5,080)                          | —                      | —   | —              | —           | (5,080)                                   | —                                | (5,080)         |
| Stock-based<br>compensation  | —            | —         | 8,656                            | —                      | —   | —              | —           | 8,656                                     | —                                | 8,656           |
| Excess tax<br>benefits from<br>stock-based<br>compensation                   | —            | —         | 1,038                            | —                      | —   | —              | —           | 1,038                                     | —                                | 1,038           |
| Balances at<br>September 30,<br>2015   | 8,667,666    | \$96      | \$1,142,182                      | \$(479,051)            | \$(902)   | 943,909        | \$(122,699) | \$539,626                                 | \$(296)                          | \$539,330       |
| Balances at<br>December 31,<br>2015  | 8,398,944    | \$96      | \$1,140,875                      | \$(472,614)            | \$(1,034)   | 1,214,144      | \$(157,699) | \$509,624                                 | \$(167)                          | \$509,457       |
| Net income   | —            | —         | —                                | 36,076                 | —   | —              | —           | 36,076                                    | —                                | 36,076          |
|  | —            | —         | —                                | —                      | 230   | —              | —           | 230                                       | —                                | 230             |

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|  |           |      |             |             |        |             |             |           |       |           |
|--|-----------|------|-------------|-------------|--------|-------------|-------------|-----------|-------|-----------|
| Net unrealized gain on securities available-for-sale             |           |      |             |             |        |             |             |           |       |           |
| Foreign currency translation adjustments                         | —         | —    | —           | —           | 569    | —           | —           | 569       | —     | 569       |
| Activity of noncontrolling interests, net                        | —         | —    | —           | (167        | ) —    | —           | —           | (167      | ) 167 | —         |
| Cash dividends declared (\$1.35 per common share)                | —         | —    | (11,003     | ) —         | —      | —           | —           | (11,003   | ) —   | (11,003   |
| Repurchases of common shares                                     | (844,671  | ) (6 | ) (47,207   | ) —         | —      | 288,155     | (25,003     | ) (72,216 | ) —   | (72,216   |
| Issuance of common shares related to employee stock transactions | 55,480    | 1    | 991         | —           | —      | —           | —           | 992       | —     | 992       |
| Taxes paid on stock-based compensation                           | —         | —    | (1,518      | ) —         | —      | —           | —           | (1,518    | )     | (1,518    |
| Stock-based compensation   | —         | —    | 8,815       | —           | —      | —           | —           | 8,815     | —     | 8,815     |
| Tax deficiencies from stock-based compensation                   | —         | —    | (1,603      | ) —         | —      | —           | —           | (1,603    | ) —   | (1,603    |
| Balances at September 30, 2016                                   | 7,609,753 | \$91 | \$1,089,350 | \$(436,705) | \$(235 | ) 1,502,299 | \$(182,702) | \$469,799 | \$—   | \$469,799 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Virtus Investment Partners, Inc.

Notes to Condensed Consolidated Financial Statements  
(Unaudited)

1. Organization and Business

Virtus Investment Partners, Inc. (the "Company," "we," "us," "our" or "Virtus"), a Delaware corporation, operates in the investment management industry through its subsidiaries.

The Company provides investment management and related services to individuals and institutions throughout the United States of America. The Company's retail investment management services are provided to individuals through products consisting of open-end mutual funds, closed-end funds, exchange traded funds ("ETFs"), variable insurance funds, Undertaking for Collective Investment in Transferable Securities ("UCITS") and separately managed accounts. Institutional investment management services are provided to corporations, multiemployer retirement funds, employee retirement systems, foundations, endowments, structured products and as a subadviser to unaffiliated mutual funds.

2. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, these financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the Company's financial condition and results of operations. Operating results for the nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

The condensed consolidated financial statements include the accounts of the Company, its subsidiaries and investment products that are consolidated. Voting interest entities ("VOEs") are consolidated when the Company is considered to have a controlling financial interest which is typically present when the Company owns a majority of the voting interest in an entity or otherwise has the power to govern the financial and operating policies of the entity.

The Company evaluates any variable interest entities ("VIEs") in which the Company has a variable interest for consolidation. A VIE is an entity in which either (a) the equity investment at risk is not sufficient to permit the entity to finance its own activities without additional financial support or (b) where as a group, the holders of the equity investment at risk do not possess: (i) the power through voting or similar rights to direct the activities that most significantly impact the entity's economic performance; (ii) the obligation to absorb expected losses or the right to receive expected residual returns of the entity; or (iii) proportionate voting and economic interests and where substantially all of the entity's activities either involve or are conducted on behalf of an investor with disproportionately fewer voting rights. If an entity has any of these characteristics, it is considered a VIE and is required to be consolidated by its primary beneficiary. The primary beneficiary is the entity that has both the power to direct the activities that most significantly impact the VIE's economic performance and has the obligation to absorb losses of, or the right to receive benefits from, the VIE that could potentially be significant to the VIE.

The Company has two types of investment products that are consolidated: consolidated sponsored investment products and the consolidated investment product. Consolidated sponsored investment products are investment products in which the Company generally holds a majority of the beneficial interests. The consolidated investment product is a collateralized loan obligation ("CLO") in which the Company has less than the majority of the beneficial interests. The secured notes of the CLO have contractual recourse only to the related assets of the CLO and are classified as financial liabilities. The consolidation and deconsolidation of these investment products have no impact on net income attributable to stockholders. The Company's risk with respect to these investments is limited to its

beneficial interests in these products. The Company has no right to the benefits from, and does not bear the risks associated with, these investment products beyond the Company's investments in, and fees generated from, these products. The Company does not consider cash and investments held by the investment products it consolidates to be assets of the Company other than its direct investment in these products. See Note 14 for additional information related to the consolidation of sponsored investment products and the investment product. Intercompany accounts and transactions have been eliminated as a result of consolidation.

These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended

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December 31, 2015 filed with the Securities and Exchange Commission. The Company's significant accounting policies, which have been consistently applied, are summarized in its 2015 Annual Report on Form 10-K.

### New Accounting Standards Implemented

The Company adopted Accounting Standards Update ("ASU") No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis ("ASU 2015-02") on January 1, 2016. This standard modifies existing consolidation guidance for reporting organizations that are required to evaluate whether they should consolidate certain entities. Certain unconsolidated entities that had been classified as VOEs under previous consolidation guidance are now classified as VIEs under ASU 2015-02. As such, disclosure for VIEs is included in Note 14 to the condensed consolidated financial statements. Adoption of this standard did not have a material impact on the Company's condensed consolidated financial statements.

The Company adopted ASU No. 2014-13, Measuring the Financial Assets and Financial Liabilities of a Consolidated Collateralized Financing Entity ("CFE") ("ASU 2014-13") on January 1, 2016. This new standard requires reporting entities to use the more observable of the fair value of the financial assets or the financial liabilities to measure the financial assets and the financial liabilities of a CFE when a CFE is initially consolidated. It permits entities to make an accounting policy election to apply this same measurement approach after initial consolidation or to apply other GAAP to account for the consolidated CFE's financial assets and financial liabilities. It also prohibits all entities from electing to use the fair value option in ASC 825, Financial Instruments, to measure either the financial assets or financial liabilities of a consolidated CFE that is within the scope of this issue. The Company has elected the measurement alternative for its consolidated investment product. The Company's subsequent earnings from the consolidated investment product will reflect changes in value of the Company's own economic interest in the consolidated investment product. Disclosures for the Company's CFE are included in Note 14 to the condensed consolidated financial statements. Adoption of this standard did not have a material impact on the Company's condensed consolidated financial statements.

The Company adopted ASU No. 2015-16 "Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments" ("ASU 2015-16") on January 1, 2016. ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. ASU 2015-16 requires that the acquirer record, in the financial statements of the period in which adjustments to provisional amounts are determined, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. Adoption of this standard did not have a material impact on the Company's condensed consolidated financial statements.

The Company adopted ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs ("ASU 2015-3") on January 1, 2016, which changes the presentation of debt issuance costs in the balance sheet. This new standard requires that debt issuance costs be presented as a deduction from the carrying amount of the related debt rather than being presented as an asset. Amortization of debt issuance costs will continue to be reported as interest expense. In August 2015, the FASB issued ASU 2015-15 to amend ASU 2015-03 to address line-of-credit agreements. ASU 2015-15 allows entities to present debt issuance costs related to line-of-credit agreements as an asset and amortize deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings. Adoption of this standard did not have a material impact on the Company's condensed consolidated financial statements.

### New Accounting Standards Not Yet Implemented

In August 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments which clarifies the treatment of several cash flow categories. In addition, ASU 2016-15 clarifies that when cash receipts and cash payments have aspects of more than one class of cash flows and cannot be separated, classification will depend on the predominant source or use. This update is effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted.



The Company is currently evaluating the potential impact of this standard on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting (ASU 2016-09"). This standard makes several modifications to Topic 718 related to the accounting for forfeitures, employer tax withholdings on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. ASU 2016-09 also clarifies the statement of cash flows presentation for certain components of share-based awards. The standard is effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption is permitted. The Company is currently evaluating the potential impact of this standard on its consolidated financial statements.

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In March 2016, the FASB issued ASU 2016-08, Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net), which amends the principal-versus-agent implementation guidance in ASU 2014-09 Revenue from Contracts with Customers; as further discussed below. The new guidance will impact whether an entity reports revenue on a gross or net basis. The Company is currently evaluating the impact of adopting ASU 2016-08, which is effective for the Company in conjunction with the adoption of ASU 2014-09.

In March 2016, the FASB issued ASU No. 2016-07, "Investments—Equity Method and Joint Ventures (Topic 232): Simplifying the Transition to the Equity Method of Accounting." This standard eliminates the requirement that when an existing cost method investment qualifies for use of the equity method, an investor must restate its historical financial statements, as if the equity method had been used during all previous periods. Under the new guidance, at the point an investment qualifies for the equity method, any unrealized gain or loss in accumulated other comprehensive income/(loss) will be recognized through earnings. The standard is effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption is permitted. The Company is currently evaluating the potential impact of this standard on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"). The standard replaces current codification Topic 840 with updated guidance on accounting for leases and requires a lessee to recognize assets and liabilities arising from an operating lease on the balance sheet, whereas previous GAAP rules did not require lease assets and liabilities to be recognized for most leases. Furthermore, companies are permitted to make an accounting policy election to not recognize lease assets and liabilities for leases with a term of 12 months or less. For both finance leases and operating leases, the lease liability should be initially measured at the present value of the lease payments. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee will not significantly change under this new guidance. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 and interim periods therein. Early adoption is permitted. The Company is currently evaluating the potential impact of this standard on its consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-1"), which requires all equity investments (other than those accounted for under the equity method) to be measured at fair value with changes in the fair value recognized through net income. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017 and interim periods therein. Early adoption is not permitted. The Company is currently evaluating the potential impact of this standard on its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. ASU 2014-09 was originally effective for fiscal years and interim periods within those years beginning after December 15, 2016. In August 2015, the FASB issued ASU 2015-14, which deferred the effective date of ASU 2014-09 by one year for periods beginning after December 15, 2017. Early adoption is permitted as of the original effective date and requires either a retrospective or a modified retrospective approach to adoption. As deferred, ASU 2014-09 is effective for the first interim period within annual reporting periods beginning after December 15, 2017 with early adoption permitted. The Company is currently evaluating the potential impact of this standard on its consolidated financial statements.

### 3. Intangible Assets, Net

Intangible assets, net are summarized as follows:

September December  
30, 2016 31, 2015

(\$ in thousands)

Definite-lived intangible assets:

|                                       |            |            |
|---------------------------------------|------------|------------|
| Investment contracts                  | \$158,747  | \$158,747  |
| Accumulated amortization              | (154,533 ) | (152,676 ) |
| Definite-lived intangible assets, net | 4,214      | 6,071      |
| Indefinite-lived intangible assets    | 34,816     | 34,816     |
| Total intangible assets, net          | \$39,030   | \$40,887   |

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Activity in intangible assets, net is as follows:

|                              | Nine Months<br>Ended September<br>30, |          |
|------------------------------|---------------------------------------|----------|
|                              | 2016                                  | 2015     |
| (\$ in thousands)            |                                       |          |
| Intangible assets, net       |                                       |          |
| Balance, beginning of period | \$40,887                              | \$41,783 |
| Additions                    | —                                     | 2,400    |
| Amortization                 | (1,857 )                              | (2,511 ) |
| Balance, end of period       | \$39,030                              | \$41,672 |

## 4. Investments

Investments consist primarily of investments in the Company's sponsored mutual funds. The Company's investments, excluding the investments of consolidated sponsored investment products and the investments of the consolidated investment product, which are separately discussed in Note 14, at September 30, 2016 and December 31, 2015 were as follows:

|                                     | September 30, December 31, |           |
|-------------------------------------|----------------------------|-----------|
|                                     | 2016                       | 2015      |
| (\$ in thousands)                   |                            |           |
| Marketable securities               | \$ 81,486                  | \$ 41,496 |
| Equity method investments           | 7,101                      | 9,007     |
| Nonqualified retirement plan assets | 5,662                      | 5,310     |
| Other investments                   | 925                        | 925       |
| Total investments                   | \$ 95,174                  | \$ 56,738 |

## Marketable Securities

The Company's marketable securities consist of both trading and available-for-sale securities. The composition of the Company's marketable securities is summarized as follows:

September 30, 2016

|                             | Cost     | Unrealized<br>Loss | Unrealized<br>Gain | Fair<br>Value |
|-----------------------------|----------|--------------------|--------------------|---------------|
| (\$ in thousands)           |          |                    |                    |               |
| Trading:                    |          |                    |                    |               |
| Sponsored funds             | \$68,284 | \$ (2,819 )        | \$ 1,404           | \$66,869      |
| Equity securities           | 10,591   | —                  | 476                | 11,067        |
| Available-for-sale:         |          |                    |                    |               |
| Sponsored closed-end funds  | 3,538    | (215 )             | 227                | 3,550         |
| Total marketable securities | \$82,413 | \$ (3,034 )        | \$ 2,107           | \$81,486      |

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December 31, 2015

|                             | Cost     | Unrealized<br>Loss | Unrealized<br>Gain | Fair<br>Value |
|-----------------------------|----------|--------------------|--------------------|---------------|
| (\$ in thousands)           |          |                    |                    |               |
| Trading:                    |          |                    |                    |               |
| Sponsored funds             | \$31,167 | \$ (2,134 )        | \$ 298             | \$29,331      |
| Equity securities           | 9,434    | (386 )             | 120                | 9,168         |
| Available-for-sale:         |          |                    |                    |               |
| Sponsored closed-end funds  | 3,355    | (365 )             | 7                  | 2,997         |
| Total marketable securities | \$43,956 | \$ (2,885 )        | \$ 425             | \$41,496      |

For the three months ended September 30, 2016, the Company recognized a net realized gain of \$0.1 million on trading securities and for the nine months ended September 30, 2016, the Company recognized a net realized loss of \$0.3 million on trading securities. For the three and nine months ended September 30, 2015, the Company recognized net realized losses of \$0.5 million and \$0.4 million, respectively, on trading securities.

## 5. Fair Value Measurements

The Company's assets and liabilities measured at fair value on a recurring basis, excluding the assets and liabilities of consolidated sponsored investment products and the consolidated investment product, which are separately discussed in Note 14, as of September 30, 2016 and December 31, 2015 by fair value hierarchy level were as follows:

September 30, 2016

|   | Level 1   | Level 2 | Level 3 | Total      |
|---|-----------|---------|---------|------------|
| (\$ in thousands)                         |           |         |         |            |
| Assets                                    |           |         |         |            |
| Cash equivalents                          | \$138,303 | \$ —    | —       | —\$138,303 |
| Marketable securities trading:            |           |         |         |            |
| Sponsored funds                           | 66,869    | —       | —       | 66,869     |
| Equity securities                         | 11,067    | —       | —       | 11,067     |
| Marketable securities available-for-sale: |           |         |         |            |
| Sponsored closed-end funds                | 3,550     | —       | —       | 3,550      |
| Other investments:                        |           |         |         |            |
| Nonqualified retirement plan assets       | 5,662     | —       | —       | 5,662      |
| Total assets measured at fair value       | \$225,451 | \$ —    | —       | —\$225,451 |

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December 31, 2015

|   | Level 1   | Level 2 | Level 3 | Total      |
|---|-----------|---------|---------|------------|
| (\$ in thousands)                         |           |         |         |            |
| Assets                                    |           |         |         |            |
| Cash equivalents                          | \$54,772  | \$ —    | —\$     | —\$54,772  |
| Marketable securities trading:            |           |         |         |            |
| Sponsored funds                           | 29,331    | —       | —       | 29,331     |
| Equity securities                         | 9,168     | —       | —       | 9,168      |
| Marketable securities available-for-sale: |           |         |         |            |
| Sponsored closed-end funds                | 2,997     | —       | —       | 2,997      |
| Other investments                         |           |         |         |            |
| Nonqualified retirement plan assets       | 5,310     | —       | —       | 5,310      |
| Total assets measured at fair value       | \$101,578 | \$ —    | —\$     | —\$101,578 |

The following is a discussion of the valuation methodologies used for the Company's assets measured at fair value:

Cash equivalents represent investments in money market funds. Cash investments in actively traded money market funds are valued using published net asset values and are classified as Level 1.

Sponsored funds represent investments in open-end mutual funds, variable insurance funds and closed-end funds for which the Company acts as the investment manager. The fair value of open-end mutual funds and variable insurance funds is determined based on their published net asset values and are categorized as Level 1. The fair value of closed-end funds is determined based on the official closing price on the exchange on which they are traded and are categorized as Level 1.

Equity securities include securities traded on active markets and are valued at the official closing price (typically last sale or bid) on the exchange on which the securities are primarily traded and are categorized as Level 1.

Nonqualified retirement plan assets represent mutual funds within a nonqualified retirement plan whose fair value is determined based on their published net asset value and are categorized as Level 1.

Cash, accounts receivable, accounts payable and accrued liabilities equal or approximate fair value based on the short-term nature of these instruments.

Transfers into and out of levels are reflected when (1) significant inputs used for the fair value measurement, including market inputs or performance attributes, become observable or unobservable, (2) when the Company determines it has the ability, or no longer has the ability, to redeem, in the near term, certain investments that the Company values using a net asset value, or (3) if the book value no longer represents fair value. There were no transfers between levels during the three and nine months ended September 30, 2016 and 2015.

## 6. Equity Transactions

During the nine months ended September 30, 2016 and 2015, the Company repurchased 844,671 and 368,468 common shares, respectively, at a weighted average price of \$83.94 and \$122.09 per share, respectively, for a total cost, including fees and expenses, of approximately \$72.2 million and \$45.0 million, respectively. The 844,671 shares repurchased during the nine months ended September 30, 2016 included 556,516 shares repurchased pursuant to a tender offer that was completed in the second quarter of 2016. Shares repurchased under the tender offer were at a price of \$82.50 per share for an aggregate cost of \$47.2 million, or \$84.81 per share including fees and expenses and were retired by the Company.

Excluding share repurchased under the tender offer described above, the Company has repurchased a total of 1,502,299 shares of common stock at a weighted average price of \$121.58 per share plus transaction costs for a total cost of \$182.7 million under its share repurchase program. At September 30, 2016, there were 1,197,701 shares of common stock available to repurchase under the Company's current share repurchase program.



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On October 27, 2016, the Company entered into and completed a Stock Purchase Agreement with Bank of Montreal Holdings Inc. (“BMO”) to purchase 1,727,746 shares of the Company’s common stock at a price of \$93.50 per share for a total purchase price of \$161.5 million. To effect this transaction, the Company used \$131.5 million of cash and cash equivalents and borrowed \$30.0 million on its Credit Facility. The purchase represented all of the shares held by BMO and reflected approximately 22.7% of the Company’s outstanding common stock at September 30, 2016.

In connection with the purchase, the Board of Directors authorized an additional 730,045 shares to cover the incremental shares purchased beyond the remaining 1,197,701 shares available for repurchase under the Company's previously approved share repurchase program. After the completion of this transaction there were 200,000 shares remaining for future share repurchases.

The Board of Directors declared cash dividends of \$0.45 per share in each of the first three quarters of 2016 and 2015. Total dividends declared were \$11.0 million and \$12.1 million for the nine months ended September 30, 2016 and 2015, respectively. Dividends declared in the third quarter of 2016 will be paid on November 11, 2016 to all shareholders of record on October 31, 2016.

#### 7. Accumulated Other Comprehensive Income (Loss)

The changes in accumulated other comprehensive income (loss) by component for the nine months ended September 30, 2016 and 2015 were as follows:

|  | Unrealized<br>Gains<br>and (Losses)<br>on Securities<br>Available-for-<br>Sale | Foreign<br>Currency<br>Translation<br>Adjustments |
|--|--|---|
| (\$ in thousands)  |  |   |
| Balance December 31, 2015  | \$ (465 )  | \$ (569 )   |
| Unrealized net gains on securities available-for-sale, net of tax of (\$140) | 230  | —   |
| Foreign currency translation adjustments, net of tax of (\$348)              | —  | 569   |
| Amounts reclassified from accumulated other comprehensive income             | —  | —   |
| Net current-period other comprehensive income                                | 230  | 569   |
| Balance September 30, 2016   | \$ (235 )  | \$ —  |

|  | Unrealized<br>Gains<br>and (Losses)<br>on Securities<br>Available-for-<br>Sale | Foreign<br>Currency<br>Translation<br>Adjustments |
|--|--|---|
| (\$ in thousands)  |  |   |
| Balance December 31, 2014  | \$ (107 )  | \$ (135 )   |
| Unrealized net losses on securities available-for-sale, net of tax of \$26 | (389 )   | —   |
| Foreign currency translation adjustments, net of tax of \$167              | —  | (271 )  |
| Amounts reclassified from accumulated other comprehensive income           | —  | —   |
| Net current-period other comprehensive loss                                | (389 )   | (271 )  |
| Balance September 30, 2015   | \$ (496 )  | \$ (406 )   |

#### 8. Stock-based Compensation



The Company has an Amended and Restated Omnibus Incentive and Equity Plan (the “Plan”) under which officers, employees and directors may be granted equity-based awards, including restricted stock units (“RSUs”), stock options and unrestricted shares of common stock. On May 25, 2016, the shareholders of the Company approved an amendment to the Plan which increased the number of shares of common stock available under the Plan by 600,000, bringing the total number of

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authorized shares to 2,400,000. At September 30, 2016, 768,981 shares of common stock remained available for issuance of the 2,400,000 shares that were reserved for issuance under the Plan.

Each RSU entitles the holder to one share of common stock when the restriction expires. RSUs generally have a term of one to three years and may be time-vested or performance-contingent. The fair value of each RSU is estimated using the intrinsic value method, which is based on the fair market value price on the date of grant unless it contains a performance metric that is considered a market condition. RSUs that contain a market condition are valued using a simulation valuation model. Shares that are issued upon exercise of stock options and vesting of RSUs are newly issued shares from the Plan and are not issued from treasury stock. Stock options generally cliff vest after three years and have a contractual life of 10 years. Stock options are granted with an exercise price equal to the fair market value of the shares at the date of grant.

## Restricted Stock Units

RSU activity for the nine months ended September 30, 2016 is summarized as follows:

|                                   | Number<br>of Shares | Weighted<br>Average<br>Grant Date<br>Fair Value |
|-----------------------------------|---------------------|---|
| Outstanding at December 31, 2015  | 191,617             | \$ 156.66                                       |
| Granted                           | 155,361             | \$ 75.72  |
| Forfeited                         | (8,333 )            | \$ 110.81                                       |
| Settled                           | (55,233 )           | \$ 167.34                                       |
| Outstanding at September 30, 2016 | 283,412             | \$ 111.56                                       |

For the nine months ended September 30, 2016 and 2015, a total of 19,457 and 37,488 RSUs, respectively, were withheld by the Company as a result of net share settlements to settle minimum employee tax withholding obligations. The Company paid \$1.5 million and \$5.1 million for the nine months ended September 30, 2016 and 2015, respectively, in minimum employee tax withholding obligations related to RSUs withheld. These net share settlements had the effect of share repurchases by the Company as they reduced the number of shares that would have been otherwise issued as a result of the vesting.

During the nine months ended September 30, 2016, the Company granted 33,244 RSUs which contain performance based metrics in addition to a service condition. The performance metrics are based on the Company's growth in operating income, as adjusted, relative to peers, over a one-year period and total shareholder return ("TSR") relative to peers over a three-year period. For the nine months ended September 30, 2016, total stock-based compensation expense included \$0.2 million for these performance contingent RSUs.

The Company recognized total stock compensation expense of \$2.4 million and \$9.1 million, respectively, for the three and nine months ended September 30, 2016 and \$2.7 million and \$9.2 million, respectively, for the three and nine months ended September 30, 2015. As of September 30, 2016, unamortized stock-based compensation expense for unvested RSUs was \$14.8 million, with a weighted-average remaining amortization period of 1.8 years.

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## Stock Options

Stock option activity for the nine months ended September 30, 2016 is summarized as follows:

|                                   | Number<br>of Shares | Weighted<br>Average<br>Exercise Price |
|-----------------------------------|---------------------|---------------------------------------|
| Outstanding at December 31, 2015  | 156,636             | \$ 18.78                              |
| Granted                           | —                   | \$ —                                  |
| Exercised                         | (12,729 )           | \$ 33.56                              |
| Forfeited                         | —                   | \$ —                                  |
| Outstanding at September 30, 2016 | 143,907             | \$ 17.47                              |

## 9. Restructuring and Severance

During the three months ended September 30, 2016, the Company incurred severance costs of \$1.9 million associated with select staff reductions. During the nine months ended September 30, 2016, the Company incurred \$3.9 million in severance costs related to staff reductions, primarily in business support areas and \$0.4 million in costs related to future lease obligations and leasehold improvement write-offs for vacated office space. Total unpaid severance and related charges as of September 30, 2016 was \$3.6 million.

## 10. Earnings per Share

Basic earnings per share (“EPS”) excludes dilution for potential common stock issuances and is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. For the calculation of diluted EPS, the basic weighted-average number of shares is increased by the dilutive effect of RSUs and common stock options using the treasury stock method.

The computation of basic and diluted EPS is as follows:

|  | Three Months<br>Ended September<br>30, |           | Nine Months<br>Ended September<br>30, |          |
|--|--|-----------|---------------------------------------|----------|
|  | 2016                                   | 2015      | 2016                                  | 2015     |
| (\$ in thousands, except per share amounts)                              |  |           |                                       |          |
| Net Income (Loss)  | \$16,276                               | \$(3,703) | \$36,846                              | \$25,034 |
| Noncontrolling interests   | (651 )                                 | 3,054     | (770 )                                | 3,436    |
| Net Income (Loss) Attributable to Common Stockholders                    | \$15,625                               | \$(649 )  | \$36,076                              | \$28,470 |
| Shares (in thousands):   |  |           |                                       |          |
| Basic: Weighted-average number of shares outstanding                     | 7,676                                  | 8,775     | 8,062                                 | 8,876    |
| Plus: Incremental shares from assumed conversion of dilutive instruments | 178                                    | —         | 161                                   | 163      |
| Diluted: Weighted-average number of shares outstanding                   | 7,854                                  | 8,775     | 8,223                                 | 9,039    |
| Earnings (Loss) per Share—Basic  | \$2.04                                 | \$(0.07 ) | \$4.47                                | \$3.21   |
| Earnings (Loss) per Share—Diluted  | \$1.99                                 | \$(0.07 ) | \$4.39                                | \$3.15   |

For the three and nine months ended September 30, 2016, there were 11,502 and 10,630 instruments, respectively, excluded from the above computations of weighted-average shares for diluted EPS, and for the three and nine months ended September 30, 2015, there were 323,570 and 2,028 instruments, respectively, excluded from the above computations of weighted-average shares for diluted EPS, because the effect would be anti-dilutive.

## 11. Income Taxes

In calculating the provision for income taxes, the Company uses an estimate of the annual effective tax rate based upon the facts and circumstances at each interim period. On a quarterly basis, the estimated annual effective tax rate is adjusted,

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as appropriate, based upon changes in facts and circumstances, if any, as compared to those forecasted at the beginning of the fiscal year and each interim period thereafter.

The provision for income taxes reflected U.S. federal, state and local taxes at an estimated effective tax rate of 35.8% and 53.1% for the nine months ended September 30, 2016 and 2015, respectively. The decrease in the estimated effective tax rate was primarily due to changes in the valuation allowances related to market adjustments on the Company's marketable securities.

### 12. Credit Facility

On September 30, 2016, the Company entered into a new senior unsecured revolving credit facility ("Credit Facility") replacing the previous senior secured revolving credit facility. The Credit Facility has a five-year term and provides borrowing capacity of up to \$150.0 million, with an increase provision conditioned on approval by the lending group, to a borrowing capacity of \$200.0 million. In addition, the Credit Facility has a \$7.5 million sub-limit for the issuance of standby letters of credit. At September 30, 2016 and December 31, 2015, no amounts were outstanding under the Credit Facility. As of September 30, 2016, the Company had the capacity to draw on the full amount of the Credit Facility. Amounts outstanding under the Credit Facility bear interest at an annual rate equal to, at the Company's option, either LIBOR for interest periods of one, two, three or six months or an alternate base rate (as defined in the Credit Facility agreement), plus, in each case, an applicable margin, that ranges from 0.75% to 2.25%. Under the terms of the Credit Facility, the Company is also required to pay certain fees, including an annual commitment fee that ranges from 0.30% to 0.45% on undrawn amounts and a letter of credit participation fee at an annual rate equal to the applicable margin as well as any applicable fronting fees, each of which is payable quarterly in arrears.

The credit agreement governing the Credit Facility contains customary restrictive covenants on the Company and its subsidiaries. Restrictive covenants in the credit agreement include, but are not limited to: prohibitions on creating, incurring or assuming any liens; entering into merger arrangements; selling, leasing, transferring or otherwise disposing of assets; making a material change in the nature of the business; entering into transactions with affiliates; and incurring indebtedness through the subsidiaries. Many of these restrictions are subject to certain minimum thresholds and exceptions. Financial covenants under the credit agreement include: (i) the quarterly maintenance of a leverage ratio (total debt to adjusted EBITDA), as defined in the credit agreement, of not greater than 3.00:1.00, and (ii) a minimum interest coverage ratio (EBITDA to interest expense) for the four consecutive fiscal quarters ended before the date of determination) of not less than 4.00:1.00.

The credit agreement governing the Credit Facility also contains customary provisions regarding events of default which could result in an acceleration or increase in amounts due, including (subject to certain materiality thresholds and grace periods) payment default, failure to comply with covenants, material inaccuracy of a representation or warranty, bankruptcy or insolvency proceedings, change of control, certain judgments, ERISA matters, cross-default to other debt agreements, governmental action prohibiting or restricting the company or its subsidiaries in a manner that has a material adverse effect and failure of certain guaranty obligations. The lenders (and their respective affiliates) may have provided, and may in the future provide, investment banking, cash management, underwriting, lending, commercial banking, leasing, foreign exchange, trust or other advisory services to the company and its subsidiaries and affiliates. These parties may have received, and may in the future receive, customary compensation for these services.

### 13. Commitments and Contingencies

#### Legal Matters

The Company is regularly involved in litigation and arbitration as well as examinations, inquiries and investigations by various regulatory bodies, including the Securities and Exchange Commission ("SEC"), involving its compliance with, among other things, securities laws, client investment guidelines, laws governing the activities of broker-dealers and other laws and regulations affecting its products and other activities. Legal and regulatory matters of this nature involve or may involve but are not limited to the Company's activities as an employer, issuer of securities, investor, investment adviser, broker-dealer or taxpayer. In addition, in the normal course of business, the Company discusses matters with its regulators raised during regulatory examinations or is otherwise subject to their inquiry. These matters could result in censures, fines, penalties or other sanctions.

The Company accrues for a liability when it is both probable that a liability has been incurred and the amount of the liability can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. In addition, in the event the Company determines that a loss is not

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probable, but is reasonably possible, and it becomes possible to develop what the Company believes to be a reasonable range of possible loss, then the Company will include disclosures related to such matter as appropriate and in compliance with ASC 450, Loss Contingencies. The disclosures, accruals or estimates, if any, resulting from the foregoing analysis are reviewed at least quarterly and adjusted to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. Based on information currently available, available insurance coverage and established reserves, the Company believes that the outcomes of its legal and regulatory proceedings are not likely, either individually or in the aggregate, to have a material adverse effect on the Company's results of operations, cash flows or its consolidated financial condition. However, in the event of unexpected subsequent developments and given the inherent unpredictability of these legal and regulatory matters, the Company can provide no assurance that its assessment of any claim, dispute, regulatory examination or investigation or other legal matter will reflect the ultimate outcome and an adverse outcome in certain matters could, from time to time, have a material adverse effect on the Company's results of operations or cash flows in particular quarterly or annual periods.

In re Virtus Investment Partners, Inc. Securities Litigation; formerly Tom Cummins v. Virtus Investment Partners Inc. et al

On February 20, 2015, a putative class action complaint alleging violations of certain provisions of the federal securities laws was filed by an individual shareholder against the Company and certain of the Company's current officers (the "defendants") in the United States District Court for the Southern District of New York (the "Court"). On April 21, 2015, three plaintiffs, including the original plaintiff, filed motions to be appointed lead plaintiff and, on June 9, 2015, the Court appointed Arkansas Teachers Retirement System lead plaintiff. On August 21, 2015, plaintiff filed a Consolidated Class Action Complaint (the "Consolidated Complaint") amending the originally filed complaint, which was purportedly filed on behalf of all purchasers of the Company's common stock between January 25, 2013 and May 11, 2015 (the "Class Period"). The Consolidated Complaint alleges that, during the Class Period, the defendants disseminated materially false and misleading statements and concealed material adverse facts relating to certain funds formerly subadvised by F-Squared Investments Inc. ("F-Squared"). The Consolidated Complaint alleges claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Rule 10b-5. The plaintiff seeks to recover unspecified damages. A motion to dismiss the Consolidated Complaint was filed on behalf of the Company and the other defendants on October 21, 2015. On July 1, 2016, the Court entered an opinion and order granting in part, and denying in part, the motion to dismiss, narrowing Plaintiff's claims under Sections 10(b) and 20(a) of the Exchange Act and dismissing one of the defendants from the suit. The remaining defendants' Answer to the Consolidated Complaint was filed on August 5, 2016. The Company believes that the suit is without merit and intends to defend it vigorously. The Company believes that there is not a material loss that is probable and reasonably estimable related to this claim.

Mark Youngers v. Virtus Investment Partners, Inc. et al

On May 8, 2015, a putative class action complaint alleging violations of certain provisions of the federal securities laws was filed in the United States District Court for the Central District of California (the "District Court") by an individual who alleges he is a former shareholder of one of the Virtus mutual funds formerly subadvised by F-Squared and formerly known as the AlphaSector Funds. The complaint alleges claims against the Company, certain of the Company's officers and affiliates, and certain other parties (the "defendants"). The complaint was purportedly filed on behalf of purchasers of the AlphaSector Funds between May 8, 2010 and December 22, 2014, inclusive (the "Class Period"). The complaint alleges that, during the Class Period, the defendants disseminated materially false and misleading statements and concealed or omitted material facts necessary to make the statements made not misleading. On June 7, 2015, a group of three individuals, including the original plaintiff, filed a motion to be appointed lead plaintiff and on July 27, 2015, the District Court appointed movants as lead plaintiff. On October 1, 2015, the plaintiffs filed a First Amended Class Action Complaint which, among other things, added a derivative

claim for breach of fiduciary duty on behalf of Virtus Opportunities Trust. On October 19, 2015, the District Court entered an order transferring the action to the Southern District of New York (the "Court"). On January 4, 2016, the Plaintiffs filed a Second Amended Complaint. A motion to dismiss was filed on behalf of the Company and affiliated defendants on February 1, 2016. On July 1, 2016, the Court entered an opinion and order granting in part, and denying in part, the motion to dismiss. The Court dismissed four causes of action entirely and a fifth cause of action with respect to a portion of the Class Period. The Court also dismissed all claims against ten defendants named in the Complaint. The Court held that the Plaintiffs may pursue certain securities claims under Sections 10(b) and 20(a) of the Exchange Act and Section 12 of the Securities Act of 1933. The Answer to the Second Amended Complaint was filed on August 5, 2016. A Stipulation of Voluntary Dismissal of the claim under Section 12 of the Securities Act was filed on September 15, 2016. The defendants filed a motion to certify an interlocutory appeal of the July 1, 2016 order to the Court of Appeals for the Second Circuit on August 26, 2016. Oral argument on the motion was held on October 7, 2016. The Company believes that the suit has no basis in law or fact and intends to defend it vigorously. The Company believes that there is not a material loss that is probable and reasonably estimable related to this claim.



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## 14. Consolidation

## Consolidated Sponsored Investment Products

As of September 30, 2016 and December 31, 2015, the Company consolidated 18 and 12 sponsored investment products, respectively. During the nine months ended September 30, 2016, the Company consolidated 11 additional sponsored investment products and deconsolidated five sponsored investment products in which it no longer held a majority voting interest.

Consolidated sponsored investment products that are voting interest entities ("VOEs") are funds in which the Company has a controlling financial interest. Consolidated sponsored investment products are typically consolidated when the Company makes an initial investment in a newly launched fund as the Company typically owns a majority of the voting interest and are deconsolidated when the Company redeems its investment or its voting interests decrease to a minority percentage.

The Company has one consolidated sponsored investment product that is a global fund that is considered a variable interest entity ("VIE") for which the Company is the primary beneficiary. The Company determined that it is the primary beneficiary of the VIE as the Company has the power to direct the activities that most significantly impact the economic performance of the entity and has the obligation to absorb losses, or the rights to receive benefits from, the VIE that could potentially be significant to the VIE. As of September 30, 2016, the Company consolidated one sponsored investment product that was a VIE.

The following table presents the balances of the consolidated sponsored investment products that, after intercompany eliminations, were reflected in the Condensed Consolidated Balance Sheets as of September 30, 2016 and December 31, 2015:

|   | As of              |                   | As of              |                   |
|---|--------------------|-------------------|--------------------|-------------------|
|   | September 30, 2016 | December 31, 2015 | September 30, 2016 | December 31, 2015 |
|   | VOEs               | VIE               | VOEs               | VIE               |
| (\$ in thousands)   |                    |                   |                    |                   |
| Total cash and cash equivalents   | \$ 1,961           | \$ 132            | \$ 11,408          | \$ 458            |
| Total investments   | 95,452             | 41,688            | 291,247            | 32,088            |
| All other assets  | 1,943              | 617               | 8,281              | 268               |
| Total liabilities   | (2,538 )           | (392 )            | (14,948 )          | (439 )            |
| Redeemable noncontrolling interests                                       | (8,816 )           | (21,485 )         | (61,236 )          | (12,628 )         |
| The Company's net interests in consolidated sponsored investment products | \$ 88,002          | \$ 20,560         | \$ 234,752         | \$ 19,747         |

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## Fair Value Measurements

The assets and liabilities of the consolidated sponsored investment products measured at fair value on a recurring basis as of September 30, 2016 and December 31, 2015 by fair value hierarchy level were as follows:

As of September 30, 2016

|  | Level 1  | Level 2   | Level 3 | Total     |
|--|----------|-----------|---------|-----------|
| (\$ in thousands)                        |          |           |         |           |
| Assets                                   |          |           |         |           |
| Debt securities                          | \$—      | \$98,727  | \$ 146  | \$98,873  |
| Equity securities                        | 33,524   | 4,743     | —       | 38,267    |
| Derivatives                              | —        | 6         | —       | 6         |
| Total Assets Measured at Fair Value      | \$33,524 | \$103,476 | \$ 146  | \$137,146 |
| Liabilities                              |          |           |         |           |
| Derivatives                              | \$—      | \$188     | \$ —    | \$188     |
| Short sales                              | 522      | —         | —       | 522       |
| Total Liabilities Measured at Fair Value | \$522    | \$188     | \$ —    | \$710     |

As of December 31, 2015

|  | Level 1   | Level 2   | Level 3 | Total     |
|--|-----------|-----------|---------|-----------|
| (\$ in thousands)                        |           |           |         |           |
| Assets                                   |           |           |         |           |
| Debt securities                          | \$—       | \$151,156 | \$1,397 | \$152,553 |
| Equity securities                        | 162,986   | 7,796     | —       | 170,782   |
| Derivatives                              | 33        | 738       | —       | 771       |
| Total Assets Measured at Fair Value      | \$163,019 | \$159,690 | \$1,397 | \$324,106 |
| Liabilities                              |           |           |         |           |
| Derivatives                              | \$128     | \$844     | \$—     | \$972     |
| Short sales                              | 5,334     | 75        | —       | 5,409     |
| Total Liabilities Measured at Fair Value | \$5,462   | \$919     | \$—     | \$6,381   |

The following is a discussion of the valuation methodologies used for the assets and liabilities of the Company's consolidated sponsored investment products measured at fair value.

Investments of consolidated sponsored investment products represent the underlying debt, equity and other securities held in sponsored products which are consolidated by the Company. Equity securities are valued at the official closing price on the exchange on which the securities are traded and are categorized within Level 1. Level 2 investments include most debt securities, which are valued based on quotations received from independent pricing services or from dealers who make markets in such securities and certain equity securities, including non-US securities, for which closing prices are not readily available or are deemed to not reflect readily available market prices and are valued using an independent pricing service. Pricing services do not provide pricing for all securities, and therefore indicative bids from dealers are utilized, which are based on pricing models used by market makers in the security and are also included within Level 2. Level 3 investments include debt securities that are not widely traded, are illiquid or are priced by dealers based on pricing models used by market makers in the security.

For the nine months ended September 30, 2016 and 2015, securities held by consolidated sponsored investment products with an end of period value of \$0.3 million and \$8.9 million, respectively, were transferred from Level 2 to Level 1 because certain non-U.S. securities quoted market prices were no longer adjusted based on third-party factors derived from model-based valuation techniques for which the significant assumptions were observable in the market. For the nine months ended September 30, 2016 and 2015, securities held by consolidated sponsored investment products with an end of period value of 0.5 million and \$0.3 million, respectively, were transferred from Level 1 to

Level 2 because certain non-U.S.

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securities quoted market prices were adjusted based on third-party factors derived from model-based valuation techniques for which the significant assumptions were observable in the market.

The following table is a reconciliation of assets of consolidated sponsored investment products for Level 3 investments for which significant unobservable inputs were used to determine fair value.

| (\$ in thousands)              | Nine Months<br>Ended<br>September 30, |          |
|--------------------------------|---------------------------------------|----------|
|                                | 2016                                  | 2015     |
| Level 3 Debt securities (a)    |                                       |          |
| Balance at beginning of period | \$ 1,397                              | \$ 1,065 |
| Realized losses, net           | (356 )                                | —        |
| Purchases                      | 163                                   | 135      |
| Paydowns                       | (5 )                                  | (14 )    |
| Sales                          | (1,461 )                              | (13 )    |
| Transferred to Level 2         | —                                     | (126 )   |
| Transfers from Level 2         | 58                                    | —        |
| Change in unrealized gain, net | 350                                   | (121 )   |
| Balance at end of period       | \$ 146                                | \$ 926   |

None of the securities reflected in the table were internally fair valued at September 30, 2016 or September 30, (a)2015. The investments that are categorized as Level 3 were valued utilizing third party pricing information without adjustment. Such valuations are based on unobservable inputs.

## Derivatives

The Company has certain consolidated sponsored investment products which include derivative instruments as part of their investment strategies. These derivatives may include futures contracts, options contracts and forward contracts. Derivative instruments in an asset position are classified as other assets of consolidated sponsored investment products in the Condensed Consolidated Balance Sheets. Derivative instruments in a liability position are classified as liabilities of consolidated sponsored investment products within the Condensed Consolidated Balance Sheets. The change in fair value of such derivatives is recorded in realized and unrealized gain (loss) on investments of consolidated sponsored investment products, net, in the Condensed Consolidated Statements of Operations. In connection with entering into these derivative contracts, these funds may be required to pledge to the broker an amount of cash equal to the “initial margin” requirements that varies based on the type of derivative. The cash pledged or on deposit is recorded in the Condensed Consolidated Balance Sheets of the Company as cash pledged or on deposit of consolidated sponsored investment products. The fair value of such derivatives at September 30, 2016 and 2015 was immaterial.

## Short Sales

Some of the Company’s consolidated sponsored investment products may engage in short sales, which are transactions in which a security is sold which is not owned or is owned but there is no intention to deliver, in anticipation that the price of the security will decline. Short sales are recorded in the Condensed Consolidated Balance Sheets within other liabilities of consolidated sponsored investment products.

## Consolidated Investment Product

Overview

The Company's consolidated investment product is a collateralized loan obligation ("CLO") in which the Company has a beneficial interest. The term CLO generally refers to a special purpose vehicle that owns a portfolio of investments and issues various tranches of debt and subordinated note securities to finance the purchase of those investments. The investment activities of a CLO are governed by investment guidelines, generally contained within a CLO's "indenture" and other governing documents which limit, among other things, the CLO's exposure to any single industry or obligor and provide that

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the CLO's assets satisfy certain ratings requirements. Most CLOs have a defined investment period during which they are allowed to make investments and reinvest capital as it becomes available. The CLOs are considered variable interest entities (VIE). The assets of each of the CLOs, including cash and cash equivalents, are held solely as collateral to satisfy the obligations of the CLOs. The Company does not own and has no right to the benefits from, nor does it bear the risks associated with, the assets held by the CLOs, beyond its direct investments in, and investment advisory fees generated from, the CLOs. If the Company were to liquidate, the assets of the CLOs would not be available to its general creditors, and as a result, the Company does not consider these assets available for the benefit of its investors. Additionally, the investors in the CLOs have no recourse to the Company's general assets for the debt issued by the CLOs. Therefore, this debt is not the Company's obligation. The Company consolidates entities when it is determined to be the primary beneficiary under current VIE accounting guidance.

On June 9, 2016, the Company issued a CLO with a par value of \$356.3 million consisting of six classes of senior secured floating rate notes payable with a par value of \$320.0 million and subordinated notes with a par value of \$36.3 million. Upon the launch of the CLO, the warehouse debt of \$152.6 million was repaid and the Company redeemed its preference shares while simultaneously making a \$36.3 million investment in the CLO's subordinated notes.

The CLO is a VIE and the Company consolidates the CLO's assets and liabilities as a consolidated investment product within its financial statements as it is the primary beneficiary of the VIE. The Company has determined that it is the primary beneficiary of the VIE as it has the power to direct the activities that most significantly impact the economic performance of the entity and has the obligation to absorb losses, or the rights to receive benefits from, the VIE that could potentially be significant to the VIE.

As discussed in Note 2, the Company adopted ASU 2014-13 effective January 1, 2016. This guidance requires reporting entities to use the more observable of the fair value of the financial assets or the financial liabilities to measure the financial assets and the financial liabilities of a CFE when a CFE is initially consolidated. The Company has elected the measurement alternative for its consolidated investment product and has determined that the fair value of the financial assets of the CFE is more observable than the fair value of the financial liabilities of the CFE. The Company's earnings from the consolidated investment product will reflect changes in value of the Company's beneficial interest in the consolidated investment product. The fair value of the Company's beneficial interest, which is eliminated in consolidation, is determined primarily based on an income approach. The income approach is driven by current information such as market yields and projected cash flows expected to be received from the portfolio of collateral assets based on forecasted default and recovery rates that a market participant would use in determining the current fair value of the interest. The Company utilizes unadjusted third party pricing information in determining the fair value of its beneficial interest.

The following table presents the balances of the consolidated investment product that, after intercompany eliminations, were reflected in the Condensed Consolidated Balance Sheets as of September 30, 2016 and December 31, 2015:

|  | As of     |           |
|--|-----------|-----------|
|  | September | December  |
|  | 30, 2016  | 31, 2015  |
| (\$ in thousands)  |           |           |
| Total cash equivalents   | \$12,703  | \$8,297   |
| Total investments  | 360,210   | 199,485   |
| Other assets   | 4,628     | 1,467     |
| Debt   | —         | (152,597) |
| Notes payable  | (323,852) | —         |
| Securities purchased payable and other liabilities                 | (25,704)  | (18,487)  |
| The Company's net interests in the consolidated investment product | \$27,985  | \$38,165  |

Total Investments of Consolidated Investment Product

Total investments represent bank loan investments of \$360.2 million at September 30, 2016, which comprise the majority of the CLO portfolio asset collateral, are senior secured corporate loans from a variety of industries. Bank loan investments mature at various dates between 2017 and 2024, pay interest at LIBOR plus a spread of up to 7.5% and typically range in S&P credit rating categories from BBB- to CCC-. At September 30, 2016, the fair value of the senior bank loans exceeded the unpaid principal balance by approximately \$0.1 million. No collateral assets were in default as of September 30, 2016.

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## Notes Payable of Consolidated Investment Product

The CLO has note obligations that bear interest at variable rates based on LIBOR plus a pre-defined spread ranging from 1.0% to 8.75%. The principal amounts outstanding of the note obligations issued by the CLO mature in April 2028. The CLO may elect to reinvest any prepayments received on bank loan investments prior to April 2020. Any subsequent prepayments received must be used to pay down the note obligations.

The Company's beneficial interests and maximum exposure to loss related to the consolidated investment product is limited to (i) ownership in the subordinated notes and related participations in management fees of the CLOs and (ii) accrued management fees. The secured notes of the CLO have contractual recourse only to the related assets of the CLO and are classified as financial liabilities. Although these beneficial interests are eliminated upon consolidation, the application of the measurement alternative, as adopted on January 1, 2016, prescribed by ASU 2014-13, results in the net amount of the consolidated investment product shown above to be equivalent to the beneficial interests retained by the Company at September 30, 2016 as shown in the table below:

|                                    |           |
|------------------------------------|-----------|
|                                    | As of     |
| Beneficial Interests               | September |
|                                    | 30, 2016  |
| (\$ in thousands)                  |           |
| Subordinated notes                 | \$ 27,443 |
| Accrued investment management fees | 542       |
| Total Beneficial Interests         | \$ 27,985 |

The following table represents revenue and expenses of the consolidated investment product included in the Company's Consolidated Statements of Operations for the periods indicated:

|   | Three<br>Months<br>Ended<br>September<br>30,<br>2016 | Nine<br>Months<br>Ended<br>September<br>30,<br>2016 |
|---|--|---|
| (\$ in thousands)   |  |   |
| Income:   |  |   |
| Realized and unrealized gain, net                                 | \$ 144   | \$ 2,960  |
| Interest Income   | 4,047  | 8,835   |
| Total Revenue   | \$ 4,191   | \$ 11,795   |
| Expenses:   |  |   |
| Other operating expenses  | 24   | 3,921   |
| Interest expense  | 3,788  | 10,188  |
| Total Expense   | \$ 3,812   | \$ 14,109   |
| Net Income (loss) attributable to consolidated investment product | \$ 379   | \$ (2,314 )   |

As summarized in the table below, the application of the measurement alternative as prescribed by ASU 2014-13 results in the consolidated net income summarized above to be equivalent to the Company's own economic interests in the consolidated investment product which are eliminated upon consolidation:





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|  | Three<br>Months<br>Ended<br>September<br>30,<br>2016 | Nine<br>Months<br>Ended<br>September<br>30,<br>2016 |
|--|--|---|
| Economic Interests   |  |   |
| (\$ in thousands)  |  |   |
| Distributions received and unrealized losses on the subordinated notes held by the Company | \$ (58 )   | \$ (2,857 )   |
| Investment management fees   | 437  | 543   |
| Total Economic Interests   | \$ 379   | \$ (2,314 )   |

## Fair Value Measurements of Consolidated Investment Product

The assets and liabilities of the consolidated investment product measured at fair value on a recurring basis by fair value hierarchy level were as follows:

As of September 30, 2016:

|  | Level 1  | Level 2   | Level 3 | Total      |
|--|----------|-----------|---------|------------|
| (\$ in thousands)                        |          |           |         |            |
| Assets                                   |          |           |         |            |
| Cash equivalents                         | \$12,703 | \$—       | \$      | —\$12,703  |
| Bank loans                               | —        | 360,210   | —       | 360,210    |
| Total Assets Measured at Fair Value      | \$12,703 | \$360,210 | \$      | —\$372,913 |
| Liabilities                              |          |           |         |            |
| Notes payable                            | \$—      | \$323,852 | \$      | —\$323,852 |
| Total Liabilities Measured at Fair Value | \$—      | \$323,852 | \$      | —\$323,852 |

As of December 31, 2015:

|                                     | Level 1 | Level 2   | Level 3 | Total      |
|-------------------------------------|---------|-----------|---------|------------|
| (\$ in thousands)                   |         |           |         |            |
| Assets                              |         |           |         |            |
| Cash equivalents                    | \$8,297 | \$—       | \$      | —\$8,297   |
| Bank loans                          | —       | 199,485   | —       | 199,485    |
| Total Assets Measured at Fair Value | \$8,297 | \$199,485 | \$      | —\$207,782 |

The following is a discussion of the valuation methodologies used for the assets and liabilities of the Company's consolidated investment product measured at fair value:

Cash equivalents represent investments in money market funds. Cash investments in actively traded money market funds are valued using published net asset values and are classified as Level 1.

Bank loans represent the underlying debt securities held in the sponsored product which are consolidated by the Company. Bank loan investments include debt securities, which are generally at the average mid-point of bid and ask quotations obtained from a third-party pricing service. Fair value may also be based upon valuations obtained from independent third-party brokers or dealers utilizing matrix pricing models that consider information regarding securities with similar characteristics. In certain instances, fair value has been determined utilizing discounted cash flow analyses or single broker non-binding quotes. Depending on the nature of the inputs, these assets are classified as Level 1, 2 or 3 within the fair value measurement hierarchy.

Notes payable represent notes issued by the CLO and are measured using the measurement alternative in ASU 2014-13. Accordingly, the fair value of CLO liabilities was measured as the fair value of CLO assets less the sum of

(a) the fair value of the beneficial interests held by the Company and (b) the carrying value of any beneficial interests that represent compensation for services.

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The estimated fair value of debt at December 31, 2015, which had a variable interest rate, approximated its carrying value. The securities purchase payable at September 30, 2016 and December 31, 2015 approximated fair value due to the short-term nature of the instruments.

Nonconsolidated VIEs

The Company has interests in certain entities that are VIEs that the Company does not consolidate as it is not the primary beneficiary of those entities. The Company is not the primary beneficiary as its interest in the entities does not provide the Company with the power to direct the activities that most significantly impact the entities economic performance. At September 30, 2016, the carrying value and maximum risk of loss related to these VIEs was \$8.1 million.

Certain of the Company's affiliates serve as the collateral manager for other collateralized loan and collateralized bond obligations (collectively, "CDOs"). The assets and liabilities of these CDOs reside in bankruptcy remote, special purpose entities in which the Company has no ownership in, nor holds any notes issued by, the CDOs and provides neither recourse nor guarantees. Accordingly, the Company's financial exposure to these CDOs is limited only to the collateral investment management fees it earns which the Company has concluded are "at-market" fees. These CDOs are not consolidated as the Company does not have a variable interest in these CDOs.

15. Subsequent Events

On October 27, 2016, the Company entered into and completed a Stock Purchase Agreement with Bank of Montreal Holdings Inc. ("BMO") to purchase 1,727,746 shares of the Company's common stock at a price of \$93.50 per share for a total purchase price of \$161.5 million.

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement Regarding Forward Looking Statements

This Quarterly Report on Form 10-Q contains statements that are, or may be considered to be, forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995, as amended, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended ("the Exchange Act"). All statements that are not historical facts, including statements about our beliefs or expectations, are forward-looking statements. These statements may be identified by such forward-looking terminology as “expect,” “estimate,” “plan,” “intend,” “believe,” “may,” “will,” “should,” “could,” “forecast,” “project,” “predict,” “would,” “potential,” “likely,” or similar statements or variations of such terms.

Our forward-looking statements are based on a series of expectations, assumptions and projections about our Company and the markets in which we operate. Our financial statements are not guarantees of future results or performance and involve substantial risks and uncertainty, including assumptions and projections concerning our assets under management, net cash inflows and outflows, operating cash flows and future credit facilities, for all future periods. All of our statements contained in this Quarterly Report on Form 10-Q are as of the date of this Quarterly Report on Form 10-Q only.

We can give no assurance that such expectations or forward-looking statements will prove to be correct. Actual results may differ materially. We do not undertake or plan to update or revise any such forward-looking statements to reflect actual results, changes in plans, assumptions, estimates or projections, or other circumstances occurring after the date of this Quarterly Report on Form 10-Q, even if such results, changes or circumstances make it clear that any forward-looking information will not be realized. If there are any future public statements or disclosures by us which modify or impact any of the forward-looking statements contained in or accompanying this Quarterly Report on Form 10-Q, such statements or disclosures will be deemed to modify or supersede such statements in this Quarterly Report.

Our business and our forward-looking statements involve substantial known and unknown risks and uncertainties, including those discussed under “Risk Factors,” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our 2015 Annual Report on Form 10-K, as well as the following risks and uncertainties:

(a) any reduction in our assets under management; (b) the withdrawal, renegotiation or termination of investment advisory agreements; (c) damage to our reputation; (d) failure to comply with investment guidelines or other contractual requirements; (e) the inability to attract and retain key personnel; (f) the competition we face in our business; (g) adverse regulatory and legal developments; (h) unfavorable changes in tax laws or limitations; (i) adverse developments, or changes in our relationships with, unaffiliated subadvisers; (j) changes in key distribution relationships; (k) interruptions in service or failure to provide service by third-party service providers; (l) volatility associated with our common stock; (m) civil litigation and government investigations or proceedings; (n) the risk of capital loss associated with our investments; (o) the inability to make quarterly distributions; (p) the lack of availability of required and necessary capital on satisfactory terms; (q) liabilities and losses not covered by insurance; (r) the inability to satisfy financial covenants under existing debt agreement; (s) strategic transactions and other risks and uncertainties described in our 2015 Annual Report on Form 10-K or in any of our filings with the Securities and Exchange Commission (“SEC”).

Certain other factors which may impact our continuing operations, prospects, financial results and liquidity or which may cause actual results to differ from such forward-looking statements are discussed or included in the Company’s periodic reports filed with the SEC and are available on our website at [www.virtus.com](http://www.virtus.com) under “Investor Relations.” You are urged to carefully consider all such factors.

Overview

We are a provider of investment management and related services to individuals and institutions. We use a multi-manager, multi-style approach, offering investment strategies from affiliated managers and unaffiliated subadvisers, each having its own distinct investment style, autonomous investment process and individual brand. By offering a broad array of products, we believe we can appeal to a greater number of investors, which allows us to have offerings across market cycles through changes in investor preferences. Our earnings are primarily driven by asset-based fees charged for services relating to these various products including investment management, fund administration, distribution and shareholder services.

We offer investment strategies for individual and institutional investors in different product structures and through multiple distribution channels. Our investment strategies are available in a diverse range of styles and disciplines, managed by

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a collection of boutique investment managers, both affiliated and unaffiliated. We have offerings in various asset classes (domestic and international equity, fixed income and alternative), in all market capitalizations (large, mid and small), in different styles (growth, blend and value) and with various investment approaches (fundamental, quantitative and thematic). Our retail products include open-end mutual funds, closed-end funds, exchange traded funds ("ETFs"), variable insurance funds, Undertakings for Collective Investments in Transferable Securities ("UCITs"), and separately managed accounts. We also offer certain of our investment strategies to institutional clients.

We distribute our open-end funds and exchange traded funds principally through financial intermediaries. We have broad access in the retail market, with distribution partners that include national and regional broker-dealers, independent broker-dealers and registered investment advisors, banks and insurance companies. In many of these firms, we have a number of products that are on firms' preferred "recommended" lists and on fee-based advisory programs. Our sales efforts are supported by regional sales professionals, a national account relationship group and separate teams for exchange traded funds and our retirement and insurance products.

Our separately managed accounts are distributed through financial intermediaries and directly by teams at one of our affiliated managers. Our institutional distribution strategy is an affiliate-centric and coordinated model. Through relationships with consultants, our affiliates target key market segments, including foundations and endowments, corporate, public and private pension plans, structured products, and unaffiliated mutual funds.

## Financial Highlights

Net income (loss) per diluted share was \$1.99 in the third quarter of 2016 compared to \$(0.07) in the third quarter of 2015.

Total sales (inflows) were \$3.1 billion in the third quarter of 2016 compared to \$2.5 billion in the third quarter of 2015. Net flows were \$0.5 billion in the third quarter of 2016 compared to \$(1.6) billion in the third quarter of 2015.

Assets under management were \$46.5 billion at September 30, 2016 compared to \$47.9 billion at September 30, 2015.

## Assets Under Management

At September 30, 2016, assets under management was \$46.5 billion in total assets, representing a decrease of \$1.4 billion, or 2.9% from September 30, 2015 and a decrease of \$0.9 billion or 1.9% from December 31, 2015. The decrease in assets under management from December 31, 2015 was primarily due to net outflows of \$4.3 billion partially offset by market appreciation of \$3.8 billion. Approximately \$3.1 billion, or 72%, of the \$4.3 billion in net outflows during the nine months ended September 30, 2016 were from the Virtus Emerging Markets Opportunities fund ("Emerging Markets Opportunities Fund") which had an organizational change at the fund's subadvisor. The Emerging Markets Opportunities Fund had positive net flows of \$0.1 billion for the three months ended September 30, 2016. At September 30, 2016, assets under management in the Emerging Markets Opportunities Fund were \$7.6 billion.

Average assets under management, which generally correspond to our fee-earning asset levels, were \$45.3 billion for the nine months ended September 30, 2016, a decrease of \$7.5 billion, or 14.2%, from \$52.8 billion for the nine months ended September 30, 2015. The decrease in average assets under management compared to September 30, 2015 was due to the same reasons discussed above regarding total assets under management.

## Operating Results

In the third quarter of 2016, total revenues decreased 10.9% to \$82.3 million from \$92.4 million in the third quarter of 2015. This decrease was primarily the result of a 10.1% decrease in average assets under management. Operating income decreased by 28.5% from \$23.1 million in the third quarter of 2015 to \$16.5 million in the third quarter of

2016, primarily due to decreased revenues on lower levels of average assets under management partially offset by lower operating expenses. Results for the third quarter of 2016 include restructuring and severance expenses of \$1.9 million.



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## Assets Under Management by Product

The following table summarizes our assets under management by product:

|                                 | As of September 30, |            | Change      |         |
|---------------------------------|---------------------|------------|-------------|---------|
|                                 | 2016                | 2015       | \$          | %       |
| (\$ in millions)                |                     |            |             |         |
| Fund assets                     |                     |            |             |         |
| Open-end funds (1)              | \$25,266.4          | \$29,716.4 | \$(4,450.0) | (15.0)% |
| Closed-end funds                | 6,887.3             | 6,349.8    | 537.5       | 8.5 %   |
| Exchange traded funds           | 460.6               | 306.9      | 153.7       | 50.1 %  |
| Total fund assets               | 32,614.3            | 36,373.1   | (3,758.8 )  | (10.3)% |
| Separately managed accounts (2) | 7,924.8             | 6,539.6    | 1,385.2     | 21.2 %  |
| Total retail assets             | 40,539.1            | 42,912.7   | (2,373.6 )  | (5.5 )% |
| Total institutional assets (2)  | 6,000.4             | 5,025.0    | 975.4       | 19.4 %  |
| Total Assets Under Management   | \$46,539.5          | \$47,937.7 | \$(1,398.2) | (2.9 )% |
| Average Assets Under Management | \$45,335.0          | \$52,843.7 | \$(7,508.7) | (14.2)% |

(1)Includes assets under management of open-end mutual funds, UCITS and variable insurance funds.

(2)Includes assets under management related to option strategies and structured products.

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## Asset Flows by Product

The following table summarizes our asset flows by product:

| (\$ in millions)                       | Three Months Ended    |            | Nine Months Ended     |             |
|--|-----------------------|------------|-----------------------|-------------|
|  | September 30,<br>2016 | 2015       | September 30,<br>2016 | 2015        |
| <b>Open-End Funds (1)</b>              |                       |            |                       |             |
| Beginning balance                      | \$24,813.8            | \$33,345.3 | \$28,882.1            | \$37,514.2  |
| Inflows                                | 1,882.5               | 1,866.2    | 5,427.8               | 7,499.9     |
| Outflows                               | (2,139.4 )            | (3,736.0 ) | (10,733.5 )           | (13,308.5 ) |
| Net flows                              | (256.9 )              | (1,869.8 ) | (5,305.7 )            | (5,808.6 )  |
| Market performance                     | 736.5                 | (1,780.9 ) | 1,919.9               | (1,936.7 )  |
| Other (2)                              | (27.0 )               | 21.8       | (229.9 )              | (52.5 )     |
| Ending balance                         | \$25,266.4            | \$29,716.4 | \$25,266.4            | \$29,716.4  |
| <b>Closed-End Funds</b>                |                       |            |                       |             |
| Beginning balance                      | \$6,959.6             | \$6,901.0  | \$6,222.3             | \$7,581.4   |
| Inflows                                | —                     | —          | —                     | —           |
| Outflows                               | —                     | —          | (103.3 )              | —           |
| Net flows                              | —                     | —          | (103.3 )              | —           |
| Market performance                     | (63.3 )               | (380.4 )   | 839.7                 | (830.6 )    |
| Other (2)                              | (9.0 )                | (170.8 )   | (71.4 )               | (401.0 )    |
| Ending balance                         | \$6,887.3             | \$6,349.8  | \$6,887.3             | \$6,349.8   |
| <b>Exchange Traded Funds</b>           |                       |            |                       |             |
| Beginning balance                      | \$399.4               | \$132.6    | \$340.8               | \$—         |
| Inflows                                | 66.9                  | 217.7      | 182.0                 | 285.1       |
| Outflows                               | (19.6 )               | (13.8 )    | (74.2 )               | (26.0 )     |
| Net flows                              | 47.3                  | 203.9      | 107.8                 | 259.1       |
| Market performance                     | 19.4                  | (29.1 )    | 23.2                  | (29.5 )     |
| Other (2)                              | (5.5 )                | (0.5 )     | (11.2 )               | 77.3        |
| Ending balance                         | \$460.6               | \$306.9    | \$460.6               | \$306.9     |
| <b>Separately Managed Accounts (3)</b> |                       |            |                       |             |
| Beginning balance                      | \$7,407.2             | \$6,952.1  | \$6,784.4             | \$6,884.8   |
| Inflows                                | 516.1                 | 263.8      | 1,359.5               | 959.1       |
| Outflows                               | (182.0 )              | (334.5 )   | (860.9 )              | (1,032.0 )  |
| Net flows                              | 334.1                 | (70.7 )    | 498.6                 | (72.9 )     |
| Market performance                     | 189.9                 | (353.2 )   | 647.2                 | (241.3 )    |
| Other (2)                              | (6.4 )                | 11.4       | (5.4 )                | (31.0 )     |
| Ending balance                         | \$7,924.8             | \$6,539.6  | \$7,924.8             | \$6,539.6   |
| <b>Institutional Accounts (3)(4)</b>   |                       |            |                       |             |
| Beginning balance                      | \$5,589.7             | \$5,070.0  | \$5,155.7             | \$4,722.0   |
| Inflows                                | 612.5                 | 199.5      | 1,339.9               | 781.7       |
| Outflows                               | (252.4 )              | (110.3 )   | (834.5 )              | (344.8 )    |
| Net flows                              | 360.1                 | 89.2       | 505.4                 | 436.9       |
| Market performance                     | 60.3                  | (109.9 )   | 362.3                 | (74.2 )     |
| Other (2)                              | (9.7 )                | (24.3 )    | (23.0 )               | (59.7 )     |
| Ending balance                         | \$6,000.4             | \$5,025.0  | \$6,000.4             | \$5,025.0   |
| <b>Total</b>                           |                       |            |                       |             |
| Beginning balance                      | \$45,169.7            | \$52,401.0 | \$47,385.3            | \$56,702.4  |
| Inflows                                | 3,078.0               | 2,547.2    | 8,309.2               | 9,525.8     |
| Outflows                               | (2,593.4 )            | (4,194.6 ) | (12,606.4 )           | (14,711.3 ) |

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|                    |            |            |            |            |
|--------------------|------------|------------|------------|------------|
| Net flows          | 484.6      | (1,647.4 ) | (4,297.2 ) | (5,185.5 ) |
| Market performance | 942.8      | (2,653.5 ) | 3,792.3    | (3,112.3 ) |
| Other (2)          | (57.6 )    | (162.4 )   | (340.9 )   | (466.9 )   |
| Ending balance     | \$46,539.5 | \$47,937.7 | \$46,539.5 | \$47,937.7 |

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(1) Includes assets under management of open-end mutual funds, UCITS and variable insurance funds.

Represents open-end and closed-end mutual fund distributions, net of reinvestments, net flows of cash management

(2) strategies, net flows from non-sales related activities such as asset acquisitions/(dispositions), marketable securities investments/(withdrawals) and the impact on assets from the use of leverage.

(3) Includes assets under management related to option strategies.

Includes assets under management related to structured products. Effective April 1, 2016, the issuance/(repayment)

(4) of structured product notes are reported as inflows/(outflows). Prior to April 1, 2016, all changes in structured product AUM were reported as a component of Other.

The following table summarizes our assets under management by asset class:

| Asset Class      | As of September 30, |            | Change      |        | % of Total |        |
|------------------|---------------------|------------|-------------|--------|------------|--------|
|                  | 2016                | 2015       | \$          | %      | 2016       | 2015   |
| (\$ in millions) |                     |            |             |        |            |        |
| Equity           | \$26,669.5          | \$28,231.0 | \$(1,561.5) | (5.5)% | 57.3 %     | 58.9 % |
| Fixed income     | 15,756.8            | 15,580.6   | 176.2       | 1.1 %  | 33.9 %     | 32.5 % |
| Alternatives (1) | 3,691.6             | 3,681.7    | 9.9         | 0.3 %  | 7.9 %      | 7.7 %  |
| Other (2)        | 421.6               | 444.4      | (22.8 )     | (5.1)% | 0.9 %      | 0.9 %  |
| Total            | \$46,539.5          | \$47,937.7 | \$(1,398.2) | (2.9)% | 100.0%     | 100.0% |

(1) Consists of real estate securities, master-limited partnerships and other.

(2) Consists of option strategies.

## Average Assets Under Management and Average Basis Points

The following table summarizes the average assets under management and the average management fees earned in basis points:

| Products                        | Three Months Ended September 30,<br>Average Fees and Average Assets Under Management<br>(expressed in basis points) |      |             |             |
|---------------------------------|---|------|-------------|-------------|
|                                 | 2016  | 2015 | 2016        | 2015        |
| Open-End Funds (1)              | 50.1  | 47.3 | \$ 25,149.8 | \$ 31,627.1 |
| Closed-End Funds                | 65.9  | 66.9 | 6,853.4     | 6,714.5     |
| Exchange Traded Funds           | 32.4  | 21.9 | 426.0       | 269.9       |
| Separately Managed Accounts (2) | 53.2  | 54.5 | 7,413.7     | 6,930.9     |
| Institutional Accounts (2)      | 41.5  | 34.2 | 5,687.6     | 5,082.4     |
| All Products                    | 51.8  | 49.4 | \$ 45,530.5 | \$ 50,624.8 |
|                                 |   |      |             |             |
| Products                        | Nine Months Ended September 30,<br>Average Fees and Average Assets Under Management<br>(expressed in basis points)  |      |             |             |
|                                 | 2016  | 2015 | 2016        | 2015        |
| Open-End Funds (1)              | 48.9  | 49.8 | \$ 25,994.5 | \$ 33,692.5 |
| Closed-End Funds                | 65.6  | 67.8 | 6,555.2     | 7,030.4     |
| Exchange Traded Funds           | 34.3  | 14.3 | 378.3       | 160.9       |
| Separately Managed Accounts (2) | 54.8  | 54.1 | 7,065.7     | 6,958.3     |
| Institutional Accounts (2)      | 38.3  | 34.9 | 5,341.3     | 5,001.6     |
| All Products                    | 50.9  | 51.3 | \$ 45,335.0 | \$ 52,843.7 |



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(1)Includes assets under management of open-end mutual funds, UCITS and variable insurance funds.

(2)Includes assets under management related to option strategies.

Average fees earned represent investment management fees net of fees paid to third-party service providers for investment management related services and less the impact of investment management fees earned from consolidated sponsored investment products divided by average net assets. Mutual fund and exchange traded fund fees are calculated based on average daily or weekly net assets. Separately managed account fees are calculated based on the end of the preceding or current quarter's asset values or on an average of month-end balances. Institutional account fees are calculated based on an average of month-end balances or current quarter's asset values or for our structured products, based on the par value of the collateral assets. Average fees earned will vary based on several factors, including the asset mix and reimbursements to funds.

The average fee rate earned for the three months ended September 30, 2016 increased by 2.4 basis points compared to the same period in the prior year primarily due to a 2.8 basis point increase in the open-end mutual fund fee rate primarily attributable to a negative \$4.6 million variable incentive fee from one mutual fund in the third quarter of 2015 and a 7.3 basis point increase in the institutional account fee rate primarily due to incentive fees earned on a structured product during the three months ended September 30, 2016.

The average fee rate earned for the nine months ended September 30, 2016 decreased by 0.4 basis point compared to the same period in the prior year primarily due to a 0.9 basis point decrease in the open-end mutual fund fee rate. The decline in the open-end fund fee rate was primarily attributable to redemptions of higher fee-earning assets from September 30, 2015 to September 30, 2016. The average fee rate increase in institutional accounts for the nine months ended September 30, 2016 compared to the same periods in the prior year was primarily due to incentive fees earned on a structured product during the three months ended September 30, 2016. The structured product on which we earned an incentive fee was redeemed during the three month ended September 30, 2016.

## Results of Operations

## Summary Financial Data

|   | Three Months Ended September 30, |           |                  |           | Nine Months Ended September 30, |           |                  |           |
|---|----------------------------------|-----------|------------------|-----------|---------------------------------|-----------|------------------|-----------|
|   | 2016                             | 2015      | 2016 vs.<br>2015 | %         | 2016                            | 2015      | 2016 vs.<br>2015 | %         |
| (\$ in thousands)                                     |                                  |           |                  |           |                                 |           |                  |           |
| Results of Operations                                 |                                  |           |                  |           |                                 |           |                  |           |
| Investment management fees                            | \$60,398                         | \$64,891  | \$(4,493 )       | (6.9 )%   | \$176,234                       | \$204,254 | \$(28,020 )      | (13.7 )%  |
| Other revenue   | 21,926                           | 27,484    | (5,558 )         | (20.2 )%  | 66,470                          | 91,608    | (25,138 )        | (27.4 )%  |
| Total revenues  | 82,324                           | 92,375    | (10,051 )        | (10.9 )%  | 242,704                         | 295,862   | (53,158 )        | (18.0 )%  |
| Total operating expenses                              | 65,786                           | 69,253    | (3,467 )         | (5.0 )%   | 204,673                         | 231,990   | (27,317 )        | (11.8 )%  |
| Operating income                                      | 16,538                           | 23,122    | (6,584 )         | (28.5 )%  | 38,031                          | 63,872    | (25,841 )        | (40.5 )%  |
| Other income (expense), net                           | 4,891                            | (20,281 ) | 25,172           | 124.1 %   | 13,935                          | (19,363 ) | 33,298           | 172.0 %   |
| Interest income, net                                  | 1,716                            | 3,125     | (1,409 )         | (45.1 )%  | 5,392                           | 8,885     | (3,493 )         | (39.3 )%  |
| Income before income taxes                            | 23,145                           | 5,966     | 17,179           | 287.9 %   | 57,358                          | 53,394    | 3,964            | 7.4 %     |
| Income tax expense                                    | 6,869                            | 9,669     | (2,800 )         | (29.0 )%  | 20,512                          | 28,360    | (7,848 )         | (27.7 )%  |
| Net income (loss)                                     | 16,276                           | (3,703 )  | 19,979           | 539.5 %   | 36,846                          | 25,034    | 11,812           | 47.2 %    |
| Noncontrolling interests                              | (651 )                           | 3,054     | (3,705 )         | (121.3 )% | (770 )                          | 3,436     | (4,206 )         | (122.4 )% |
| Net income (loss) attributable to common stockholders | \$15,625                         | \$(649 )  | \$16,274         | 2,507.6 % | \$36,076                        | \$28,470  | \$7,606          | 26.7 %    |

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## Revenues

Revenues by source are as follows:

|  | Three Months Ended September 30, |          |                  |         | Nine Months Ended September 30, |           |                  |         |
|--|----------------------------------|----------|------------------|---------|---------------------------------|-----------|------------------|---------|
|  | 2016                             | 2015     | 2016 vs.<br>2015 | %       | 2016                            | 2015      | 2016 vs.<br>2015 | %       |
| (\$ in thousands)                      |                                  |          |                  |         |                                 |           |                  |         |
| Investment management fees             |                                  |          |                  |         |                                 |           |                  |         |
| Funds                                  | \$44,204                         | \$50,935 | \$(6,731)        | (13.2)% | \$131,467                       | \$162,913 | \$(31,446)       | (19.3)% |
| Separately managed accounts            | 10,267                           | 9,572    | 695              | 7.3%    | 29,470                          | 28,275    | 1,195            | 4.2%    |
| Institutional accounts                 | 5,927                            | 4,384    | 1,543            | 35.2%   | 15,297                          | 13,066    | 2,231            | 17.1%   |
| Total investment management fees       | 60,398                           | 64,891   | (4,493)          | (6.9)%  | 176,234                         | 204,254   | (28,020)         | (13.7)% |
| Distribution and service fees          | 12,116                           | 15,587   | (3,471)          | (22.3)% | 36,761                          | 52,820    | (16,059)         | (30.4)% |
| Administration and transfer agent fees | 9,588                            | 11,614   | (2,026)          | (17.4)% | 29,085                          | 37,233    | (8,148)          | (21.9)% |
| Other income and fees                  | 222                              | 283      | (61)             | (21.6)% | 624                             | 1,555     | (931)            | (59.9)% |
| Total revenues                         | \$82,324                         | \$92,375 | \$(10,051)       | (10.9)% | \$242,704                       | \$295,862 | \$(53,158)       | (18.0)% |

## Investment Management Fees

Investment management fees are earned based on a percentage of assets under management and are paid pursuant to the terms of the respective investment management contracts, which generally require monthly or quarterly payments. Investment management fees decreased by \$4.5 million, or 6.9%, for the three months ended September 30, 2016 compared to the same period in the prior year primarily due to a \$5.1 billion, or 10.1%, decrease in average assets under management. The decrease in average assets under management for the three months ended September 30, 2016 compared to the same period in the prior year was due primarily to net outflows in our open-end funds partially offset by market appreciation and positive net flows in institutional, separately managed accounts and ETFs.

Investment management fees decreased by \$28.0 million, or 13.7%, for the nine months ended September 30, 2016 compared to the same period in the prior year due to a \$7.5 billion, or 14.2%, decrease in average assets under management. The decrease in average assets under management for the nine months ended September 30, 2016 compared to the same period in the prior year was due primarily to net outflows in our open-end funds partially offset by market appreciation.

## Distribution and Service Fees

Distribution and service fees, which are asset based fees earned from open-end funds for distribution services, decreased by \$3.5 million or 22.3% and \$16.1 million or 30.4% for the three and nine months ended September 30, 2016, respectively, compared to the same periods in the prior year due to lower average open-end assets under management in share classes that have distribution and service fees.

## Administration and Transfer Agent Fees

Administration and transfer agent fees represent fees earned for fund administration and shareholder services from our open-end mutual funds and certain of our closed-end funds. Fund administration and transfer agent fees decreased by \$2.0 million or 17.4% and \$8.1 million or 21.9% for the three and nine months ended September 30, 2016, respectively, compared to the same periods in the prior year due to lower average assets under management for which the Company provides fund administration and shareholder services.

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## Other Income and Fees

Other income and fees primarily represent contingent sales charges earned from investor redemptions of certain shares sold without a front-end sales charge. Other income and fees decreased \$0.1 million or 21.6% and \$0.9 million or 59.9% for the three and nine months ended September 30, 2016 compared to the same period in the prior year primarily due to a decrease in contingent sales charges as a result of lower current year redemptions of open-end fund share classes subject to those charges.

## Operating Expenses

Operating expenses by category were as follows:

|   | Three Months Ended September 30, |          |                  |         | Nine Months Ended September 30, |           |                  |         |
|---|----------------------------------|----------|------------------|---------|---------------------------------|-----------|------------------|---------|
|   | 2016                             | 2015     | 2016 vs.<br>2015 | %       | 2016                            | 2015      | 2016 vs.<br>2015 | %       |
| (\$ in thousands)                           |                                  |          |                  |         |                                 |           |                  |         |
| Operating expenses                          |                                  |          |                  |         |                                 |           |                  |         |
| Employment expenses                         | \$33,142                         | \$33,504 | \$(362)          | (1.1)%  | \$102,184                       | \$102,719 | \$(535)          | (0.5)%  |
| Distribution and other asset-based expenses | 17,380                           | 21,717   | (4,337)          | (20.0)% | 52,913                          | 69,900    | (16,987)         | (24.3)% |
| Other operating expenses                    | 12,027                           | 12,285   | (258)            | (2.1)%  | 41,056                          | 54,298    | (13,242)         | (24.4)% |
| Restructuring and severance                 | 1,879                            | —        | 1,879            | 100.0%  | 4,270                           | —         | 4,270            | 100.0%  |
| Depreciation and amortization expense       | 1,358                            | 1,747    | (389)            | (22.3)% | 4,250                           | 5,073     | (823)            | (16.2)% |
| Total operating expenses                    | \$65,786                         | \$69,253 | \$(3,467)        | (5.0)%  | \$204,673                       | \$231,990 | \$(27,317)       | (11.8)% |

## Employment Expenses

Employment expenses primarily consist of fixed and variable compensation and related employee benefit costs. Employment expenses for the three and nine months ended September 30, 2016 were \$33.1 million and \$102.2 million, respectively, which represented a decrease of \$0.4 million or 1.1% and \$0.5 million or 0.5%, respectively, compared to the same periods in the prior year. The quarter decrease compared to prior year was due to lower fixed employment expenses as a result of a staff reduction in the second quarter of 2016. The year to date decrease from prior year was primarily due to a reduction in variable compensation, partially offset by higher fixed employment expenses primarily at our affiliates, including Virtus ETF Solutions, which was acquired in the second quarter of 2015.

## Distribution and Other Asset-Based Expenses

Distribution and other asset-based expenses consist primarily of payments to third-party distribution partners for providing services to investors in our funds and payments to third-party service providers for investment management related services. These payments are primarily based on percentages of assets under management or revenues. These expenses also include the amortization of deferred sales commissions related to up-front commissions on shares sold without a front-end sales charge to shareholders. The deferred sales commissions are amortized on a straight line basis over the periods in which commissions are generally recovered from distribution fee revenues and contingent sales charges received from shareholders of the funds upon redemption of their shares. Distribution and other asset-based expenses decreased by \$4.3 million, or 20.0%, in the three months ended September 30, 2016 and \$17.0 million, or 24.3%, in the nine months ended September 30, 2016 compared to the same periods in the prior year primarily due to lower average open-end fund assets under management and a lower percentage of assets under management in share



classes where we pay distribution expenses.

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## Other Operating Expenses

Other operating expenses primarily consist of investment research and technology costs, professional fees, travel and distribution related costs, rent and occupancy expenses, operating expenses of our consolidated sponsored investment products and other miscellaneous costs. Other operating expenses for the three months ended September 30, 2016 were relatively flat when compared to the same period in the prior year. Other operating expenses for the nine months ended September 30, 2016 decreased \$13.2 million, or 24.4%, to \$41.1 million as compared to \$54.3 million for the same period in the prior year primarily due to a \$16.5 million loss contingency recorded in the first half of 2015 related to a regulatory matter that was settled and paid in 2015. Other operating expenses of consolidated sponsored investment products and the consolidated investment product for the nine months ended September 30, 2016 increased by \$3.5 million over the prior year primarily due to expenses associated with the issuance of our CLO.

## Restructuring and Severance Expense

We incurred \$1.9 million and \$4.3 million primarily related to severance costs in the three and nine months ended September 30, 2016, respectively. The costs for the three months ended September 30, 2016 were severance costs associated with select staff reductions. For the nine months ended September 30, 2016, approximately \$3.9 million was related to severance costs associated with staff reductions, primarily in business support areas and \$0.4 million related to future lease obligations and leasehold improvements for vacated office space.

## Depreciation and Amortization Expense

Depreciation and amortization expense consists primarily of the straight-line depreciation of furniture, equipment and leasehold improvements as well as the amortization of acquired investment advisory contracts, recorded as definite-lived intangible assets, both over their estimated useful lives. Depreciation and amortization expense decreased by \$0.4 million and \$0.8 million for the three and nine months ended September 30, 2016, respectively, compared to the same periods in the prior year primarily due to certain intangible assets becoming fully amortized.

## Other (Expense) Income, net

Other (Expense) Income, net by category were as follows:

|   | Three Months Ended June 30, |            |                  |        | Nine Months Ended June 30, |            |                  |          |
|---|-----------------------------|------------|------------------|--------|----------------------------|------------|------------------|----------|
|   | 2016                        | 2015       | 2016 vs.<br>2015 | %      | 2016                       | 2015       | 2016 vs.<br>2015 | %        |
| (\$ in thousands)   |                             |            |                  |        |                            |            |                  |          |
| Other Income (Expense)  |                             |            |                  |        |                            |            |                  |          |
| Realized and unrealized gain (loss) on investments, net   | \$961                       | \$(2,082)  | \$3,043          | 146.2% | \$3,584                    | \$(1,194)  | \$4,778          | 400.2%   |
| Realized and unrealized gain (loss) on investments of consolidated sponsored investment products, net | 3,536                       | (17,619)   | 21,155           | 120.1% | 6,928                      | (18,271)   | 25,199           | 137.9%   |
| Realized and unrealized gain (loss) of consolidated investment product, net                           | 144                         | (721)      | 865              | 600.7% | 2,960                      | (721)      | 3,681            | 124.4%   |
| Other income, net   | 250                         | 141        | 109              | 77.3%  | 463                        | 823        | (360)            | (43.7)%  |
| Total Other Income (Expense), net   | \$4,891                     | \$(20,281) | \$25,172         | 124.1% | \$13,935                   | \$(19,363) | \$33,298         | (172.0)% |

Realized and unrealized gain on investments, net

Realized and unrealized gain on investments, net increased during the three and nine months ended September 30, 2016 by \$3.0 million and \$4.8 million, or 146.2%, and 400.2%, respectively, compared to the same periods in the prior year. The increase in realized and unrealized gains on investments, net for the three months ended September 30, 2016 was primarily due to unrealized gains related to our marketable securities in emerging market strategies as compared to \$2.1 million in

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unrealized losses for the three months ended September 30, 2015, which was primarily related to our marketable securities in emerging market and international strategies.

The increase in realized and unrealized gains on investments, net for the nine months ended September 30, 2016 was primarily due to a realized gain of approximately \$2.9 million on the sale of one of our equity method investments, a minority interest in a subadviser, during the nine months ended September 30, 2016 as compared to \$1.2 million in unrealized losses for the nine months ended September 30, 2015, which was primarily related to our marketable securities in emerging market and international strategies.

Realized and unrealized gain (loss) on investments of consolidated sponsored investment products, net

Realized and unrealized gains, net on investments of consolidated sponsored investment products were \$3.5 million and \$6.9 million during the three and nine months ended September 30, 2016, respectively, compared to realized and unrealized losses, net of consolidated sponsored investment products of \$17.6 million and \$18.3 million during the same periods in the prior year. The realized and unrealized gains, net for the three and nine months ended September 30, 2016 primarily consisted of unrealized gains related to emerging markets debt and target date retirement strategies. The realized and unrealized loss for the three and nine months ended September 30, 2015 was primarily attributable to unrealized losses on alternative and emerging markets debt strategies.

Realized and unrealized gain of consolidated investment product, net

Realized and unrealized gains, net of our consolidated investment product were \$0.1 million and \$3.0 million during the three and nine months ended September 30, 2016, respectively. The realized and unrealized gains, net of our consolidated investment product during the three months ended September 30, 2016, primarily consisted of \$4.2 million in unrealized gains on the investments of the consolidated investment product partially offset by \$4.1 million in changes on the note payable as a result of applying the measurement alternative of ASU 2014-13. The realized and unrealized gains, net of our consolidated investment products during the nine months ended September 30, 2016 primarily consisted of \$6.1 million in unrealized gains on the investments and \$3.1 million in changes on the note payable of the consolidated investment product as a result of applying the measurement alternative of ASU 2014-13.

Interest (Expense) Income, net

Interest (Expense) Income, net by category were as follows:

|   | Three Months Ended June 30, |          |                  |         | Nine Months Ended June 30, |          |                  |         |
|---|-----------------------------|----------|------------------|---------|----------------------------|----------|------------------|---------|
|   | 2016                        | 2015     | 2016 vs.<br>2015 | %       | 2016                       | 2015     | 2016 vs.<br>2015 | %       |
| (\$ in thousands)   |                             |          |                  |         |                            |          |                  |         |
| Interest Income (Expense)   |                             |          |                  |         |                            |          |                  |         |
| Interest expense  | \$(128 )                    | \$(138 ) | \$10             | 7.2 %   | \$(389 )                   | \$(382 ) | \$(7 )           | (1.8 )% |
| Interest and dividend income  | 221                         | 324      | \$(103 )         | (31.8)% | 1,113                      | 906      | 207              | 22.8 %  |
| Interest and dividend income of investments of consolidated sponsored investment products | 1,364                       | 2,898    | \$(1,534)        | (52.9)% | 6,021                      | 8,320    | (2,299 )         | (27.6)% |
| Interest income of consolidated investment product  | 4,047                       | 42       | \$4,005          | NM      | 8,835                      | 42       | 8,793            | NM      |
| Interest expense of consolidated investment product                                       | (3,788 )                    | (1 )     | (3,787 )         | NM      | (10,188)                   | (1 )     | (10,187)         | NM      |
| Total Interest Income, net  | \$1,716                     | \$3,125  | \$(1,409)        | (45.1)% | \$5,392                    | \$8,885  | \$(3,493)        | (39.3)% |



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## Interest and Dividend Income of Investments of Consolidated Sponsored Investment Products

Interest and dividend income of consolidated sponsored investment products decreased \$1.5 million and \$2.3 million or 52.9% and 27.6% for the three and nine months ended September 30, 2016, respectively, compared to the same periods in the prior year. The decrease was primarily due to the liquidation of three alternative funds in May 2016.

## Interest Expense and Interest Income of Consolidated Investment Product

Interest expense of consolidated investment product represents interest expense on the notes payable of the consolidated investment product. For the nine months ended September 30, 2016, interest expense included amortization of discount on notes payable of \$3.7 million related to a CLO issuance. Interest Income of consolidated investment product consists primarily of interest income from the investments of the consolidated investment product.

## Income Tax Expense

The provision for income taxes reflects U.S. federal, state and local taxes at an estimated effective tax rate of 35.8% and 53.1% for the nine months ended September 30, 2016 and 2015, respectively. The decrease in the estimated effective tax rate was primarily due to valuation allowance related market adjustments on our marketable securities.

## Liquidity and Capital Resources

## Certain Financial Data

The following table summarizes certain key financial data relating to our liquidity and capital resources:

|                           | September<br>30, 2016 | December<br>31, 2015 | Change<br>2016 vs.<br>2015 | %       |
|---------------------------|-----------------------|----------------------|----------------------------|---------|
| (\$ in thousands)         |                       |                      |                            |         |
| Balance Sheet Data        |                       |                      |                            |         |
| Cash and cash equivalents | \$ 165,421            | \$ 87,574            | \$ 77,847                  | 88.9 %  |
| Investments               | 95,174                | 56,738               | 38,436                     | 67.7 %  |
| Deferred taxes, net       | 44,623                | 54,143               | (9,520 )                   | (17.6)% |
| Dividends payable         | 4,117                 | 4,233                | (116 )                     | (2.7 )% |
| Total equity              | 469,799               | 509,457              | (39,658 )                  | (7.8 )% |

|                        | Nine Months Ended<br>September 30, |            | Change           |          |
|------------------------|------------------------------------|------------|------------------|----------|
|                        | 2016                               | 2015       | 2016 vs.<br>2015 | %        |
| (\$ in thousands)      |                                    |            |                  |          |
| Cash Flow Data:        |                                    |            |                  |          |
| Provided by (Used In): |                                    |            |                  |          |
| Operating Activities   | \$(1,130)                          | \$(56,951) | \$55,821         | (98.0 )% |
| Investing Activities   | 4,609                              | (5,419 )   | 10,028           | (185.1)% |
| Financing Activities   | 78,410                             | (12,087 )  | 90,497           | (748.7)% |

## Overview

At September 30, 2016, we had \$165.4 million of cash and cash equivalents and \$81.5 million of investments in marketable securities compared to \$87.6 million of cash and cash equivalents and \$41.5 million of investments in marketable securities at December 31, 2015. Our credit facility (the "Credit Facility") allows the Company to borrow up to \$150.0 million and expires in September 2021. At September 30, 2016, we had no outstanding borrowings under the Credit Facility.

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### Share Repurchases

As of September 30, 2016, 2.7 million shares of our common stock have been authorized to be repurchased under the share repurchase program approved by our Board of Directors, and 1.2 million shares remain available for repurchase. Under the terms of the program, the Company may repurchase shares of its common stock from time to time at its discretion through open market repurchases, privately negotiated transactions and/or other mechanisms, depending on price and prevailing market and business conditions. The program, which has no specified term, may be suspended or terminated at any time.

During the three and nine months ended September 30, 2016, we repurchased a total of 111,951 and 288,155 common shares, respectively, for approximately \$10.0 million and \$25.0 million, respectively, under the board authorized share repurchase program. Separately on June 8, 2016, we completed a \$47.2 million "modified Dutch Auction" tender offer, accepting for purchase 556,516 shares representing 6.7% of our common stock outstanding. These shares repurchased under the tender offer were not part of our share repurchase program discussed above.

On October 27, 2016, the Company entered into and completed a Stock Purchase Agreement with Bank of Montreal Holdings Inc. ("BMO") to purchase 1,727,746 shares of the Company's common stock at a price of \$93.50 per share for a total purchase price of \$161.5 million. To effect this transaction, the Company used \$131.5 million of cash and cash equivalents and borrowed \$30.0 million on its Credit Facility. The purchase represented all of the shares held by BMO and reflected approximately 22.7% of the Company's outstanding common stock at September 30, 2016.

In connection with the purchase, the Board of Directors authorized an additional 730,045 shares to cover the incremental shares purchased beyond the remaining 1,197,701 shares available for repurchase under the Company's previously approved share repurchase program. After the completion of this transaction there were 200,000 shares remaining for future share repurchases.

After giving effect to this transaction, the Company maintains adequate levels of financial flexibility with marketable securities of approximately \$74.1 million and net interests in consolidated sponsored investment products of approximately \$108.6 million, both of which are primarily invested in vehicles that provide for daily liquidity. In addition, the Company has \$120.0 million of unused capacity on its Credit Facility.

### Short-Term Capital Requirements

Our short-term capital requirements, which we consider to be those capital requirements due within one year, include payment of annual incentive compensation, income tax payments and other operating expenses, primarily consisting of investment research and technology costs, professional fees, distribution and occupancy costs. Incentive compensation, which is one of our largest annual operating cash expenditures, is paid in the first quarter of the year. In the first quarter of 2016 and 2015, we paid approximately \$42.5 million and \$45.9 million, respectively, in incentive compensation earned during the years ended December 31, 2015 and 2014, respectively. Short-term capital requirements may also be affected by employee tax withholding payments related to the net share settlement of equity awards. Our liquidity could also be impacted by certain contingencies, including any legal or regulatory settlements, described more fully in Note 13, Commitments and Contingencies, within our condensed consolidated financial statements.

### Other Uses of Capital

We expect that our main uses of cash will be to (i) invest in our organic growth, including our distribution efforts and launches of new products including CLOs, separately managed accounts or closed-end funds; (ii) seed new investment strategies and make new investments to introduce new products or to enhance distribution access; (iii) return capital to stockholders through acquisition of shares of our common stock, payment of cash dividends on our common stock or other means; (iv) fund ongoing and potential investments in our infrastructure; and (v) invest in inorganic growth



opportunities as they arise.

For the nine months ended September 30, 2016, we paid cash dividends on our common stock in the amount of \$1.35 per share, totaling \$11.1 million. On August 17, 2016, our Board of Directors declared a quarterly cash dividend of \$0.45 per common share to be paid on November 11, 2016 to shareholders of record at the close of business on October 31, 2016.

#### Capital and Reserve Requirements

We have two broker-dealer subsidiaries registered with the SEC which are subject to certain rules regarding minimum net capital, as defined by those rules. The broker-dealers are required to maintain a ratio of “aggregate indebtedness” to “net

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capital,” as defined, which may not exceed 15 to 1 and must also maintain a minimum amount of net capital. Failure to meet these requirements could result in adverse consequences to us including additional reporting requirements, a lower required ratio of aggregate indebtedness to net capital or interruption of our business. At both September 30, 2016 and December 31, 2015, the ratio of aggregate indebtedness to net capital of our broker-dealers was below the maximum allowed, and net capital was significantly greater than the required minimum.

Balance Sheet

Cash and cash equivalents consist of cash in banks and money market fund investments. Investments consist primarily of investments in our affiliated mutual funds. Consolidated sponsored investment products primarily represent investment products we sponsor and where we own a majority of the voting interest in the entity. As of September 30, 2016, we consolidated a total of 18 sponsored investment products. Our consolidated investment product represents our investment in a collateralized loan obligation ("CLO").

Operating Cash Flow

Net cash used in operating activities of \$1.1 million for the nine months ended September 30, 2016 decreased by \$55.8 million from net cash used in operating activities of \$57.0 million in the same period in the prior year. The decrease in net cash used in operating activities was due primarily to increased sales of investments of consolidated sponsored investment products and increased realized and unrealized losses offset by increased purchases of investments of the consolidated investment product.

Investing Cash Flow

Net cash provided by investing activities consists primarily of capital expenditures and other investing activities related to our business operations. Net cash provided by investing activities of \$4.6 million for the nine months ended September 30, 2016 increased by \$10.0 million from net cash used in investing activities of \$5.4 million in the same period for the prior year. The primary investing activities for the nine months ended September 30, 2016 were cash inflows of \$8.6 million related to the sale of an equity method investment offset by outflows of \$1.5 million due to capital expenditures and purchases of other investments of \$2.5 million.

Financing Cash Flow

Cash flows used in financing activities consist primarily of return of capital through repurchases of common shares and dividends, withholding obligations for the net share settlement of employee share transactions and contributions to noncontrolling interests related to our consolidated sponsored investment products. Net cash provided by financing activities increased \$90.5 million to \$78.4 million for the nine months ended September 30, 2016 as compared to net cash used in financing activities of \$12.1 million for the nine months ended September 30, 2015. The primary reason for the increase was due to cash inflows of \$316.3 million related to the issuance of notes payable by the consolidated investment product partially offset by the repayment of debt of the consolidated investment product of \$152.6 million and increased share repurchases of \$27.2 million.

Debt

On September 30, 2016, the Company entered into a new senior unsecured revolving credit facility ("Credit Facility") replacing the previous secured revolving credit facility. The Credit Facility has a five-year term and provides borrowing capacity of up to \$150.0 million, with an increase provision conditioned on approval by the lending group to bring the total borrowing capacity to \$200.0 million. In addition the Credit Facility has a \$7.5 million sub-limit for the issuance of standby letters of credit. At September 30, 2016 and December 31, 2015, no amounts were outstanding under the Credit Facility. As of September 30, 2016, the Company had the capacity to draw on the full amount of the Credit Facility. The Credit Facility contains financial covenants with respect to leverage and interest coverage and requires us to pay an annual commitment fee on any unused portion. We were in compliance with all debt covenants as of September 30, 2016.

On October 27, 2016, the Company borrowed \$30.0 million on its Credit Facility. The debt outstanding bears an interest rate of LIBOR + 175 basis points and equates to a leverage ratio of 0.4x Adjusted EBITDA within the covenant requirement of 3.0x Adjusted EBITDA, as defined in the Credit Facility. After the borrowing, the Company has \$120.0 million of unused capacity on its Credit Facility.

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## Contractual Obligations

Our contractual obligations are summarized in our 2015 Annual Report on Form 10-K. As of September 30, 2016, there have been no material changes outside of the ordinary course of business in our contractual obligations since December 31, 2015.

## Critical Accounting Policies and Estimates

Our financial statements and the accompanying notes are prepared in accordance with generally accepted accounting principles generally accepted in the United States of America, which require the use of estimates. Actual results will vary from these estimates. A discussion of our critical accounting policies and estimates is included in Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2015 Annual Report on Form 10-K. A complete description of our significant accounting policies is included in our 2015 Annual Report on Form 10-K. There were no changes in our critical accounting policies in the nine months ended September 30, 2016.

## Recently Issued Accounting Pronouncements

For a discussion of accounting standards, see Note 2 within our condensed consolidated financial statements.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk

## Market Risk

Substantially all of our revenues are derived from investment management, distribution and service and administration and transfer agent fees, which are based on the market value of assets under management. Accordingly, a decline in the prices of securities would cause our revenues and income to decline due to a decrease in the value of the assets under management. In addition, a decline in security prices could cause our clients to withdraw their investments in favor of other investments offering higher returns or lower risk, which would cause our revenues and income to decline.

We are also subject to market risk due to a decline in the market value of our investments, which consist of marketable securities, the Company's net interests in consolidated sponsored investment products and the Company's net interest in a consolidated investment product. The following table summarizes the impact of a 10% increase or decrease in the fair values of these financial instruments:

| \$ in thousands   | September 30,<br>2016 |               |
|---|-----------------------|---------------|
|   | Fair<br>Value         | 10%<br>Change |
| Marketable Securities - Available for Sale (a)                            | \$3,550               | \$355         |
| Marketable Securities - Trading (b)                                       | 77,936                | 7,794         |
| Company's net interests in Consolidated Sponsored Investment Products (c) | 108,562               | 10,856        |
| Company's net interest in Consolidated Investment Product (c)             | 27,443                | 2,744         |
| Total Investments subject to Market Risk                                  | \$217,491             | \$21,749      |

Any gains or losses arising from changes in the fair value of available-for-sale investments are recognized in accumulated other comprehensive income, net of tax, until the investment is sold or otherwise disposed of, or if the investment is determined to be other-than-temporarily impaired, at which time the cumulative gain or loss previously reported in equity is included in income. The Company evaluates the carrying value of investments for impairment on a quarterly basis. In its impairment analysis, the Company takes into consideration numerous criteria, including the duration and extent of any decline in fair value, and the intent and ability of the Company to hold the security for a period of time sufficient for a recovery in value. If the decline in value is determined to be other-than-temporary, the carrying value of the security is generally written down to fair value through the Consolidated Statement of Operations. If such a 10% increase or decrease in fair value were to occur, it would not result in an other-than-temporary impairment charge that would be material to the Company pre-tax earnings.

(b)

If such a 10% increase or decrease in fair values were to occur, the change of these trading investments would result in a corresponding increase or decrease in our pre-tax earnings.

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These represent the Company's direct investments in investment products that are consolidated. Upon consolidation, these direct investments are eliminated, and the assets and liabilities of CIP and CSIP are consolidated in the Consolidated Balance Sheet, together with a noncontrolling interest balance representing the portion of the CIP or CSIP owned by third parties. If a 10% increase or decrease in the fair values of the Company's direct investments in CIP and CSIP were to occur, it would result in a corresponding increase or decrease in our pre-tax earnings.

### Interest Rate Risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. At September 30, 2016, we were exposed to interest rate risk as a result of approximately \$174.7 million in investments in fixed and floating rate income funds/vehicles in which we have invested and which includes our net interests in consolidated sponsored investment products and our consolidated investment product. We considered a hypothetical 100 basis point change in interest rates and determined that the fair value of our fixed income investments would change by an estimated \$5.5 million.

At September 30, 2016, we had no amounts outstanding under our Credit Facility. Amounts outstanding under the Credit Facility bear interest at an annual rate equal to, at our option, either LIBOR for interest periods of one, two, three or six months or an alternate base rate (as defined in the Credit Facility agreement), plus, in each case, an applicable margin, that ranges from 0.75% to 2.25%.

At September 30, 2016, we had \$323.9 million outstanding of notes payable of our consolidated investment product. The notes bear interest at an annual rate equal to average LIBOR rate for interest periods of three months and six months plus, in each case, an applicable margin, that ranges from 1.00% to 8.75%.

## Item 4. Controls and Procedures

### Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level as of September 30, 2016, the end of the period covered by this Quarterly Report on Form 10-Q.

### Changes in Internal Controls over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) or 15d-15(f) under the Exchange Act) that occurred during the period covered by this Quarterly Report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

## Item 1. Legal Proceedings

### Legal Matters

The Company is regularly involved in litigation and arbitration as well as examinations, inquiries and investigations by various regulatory bodies, including the Securities and Exchange Commission ("SEC"), involving its compliance with, among other things, securities laws, client investment guidelines, laws governing the activities of broker-dealers and other laws and regulations affecting its products and other activities. Legal and regulatory matters of this nature involve or may involve but are not limited to the Company's activities as an employer, issuer of securities, investor, investment adviser, broker-dealer or taxpayer. In addition, in the normal course of business, the Company discusses matters with its regulators raised during

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regulatory examinations or is otherwise subject to their inquiry. These matters could result in censures, fines, penalties or other sanctions.

The Company accrues for a liability when it is both probable that a liability has been incurred and the amount of the liability can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. In addition, in the event the Company determines that a loss is not probable, but is reasonably possible, and it becomes possible to develop what the Company believes to be a reasonable range of possible loss, then the Company will include disclosures related to such matter as appropriate and in compliance with ASC 450, Loss Contingencies. The disclosures, accruals or estimates, if any, resulting from the foregoing analysis are reviewed at least quarterly and adjusted to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. Based on information currently available, available insurance coverage and established reserves, the Company believes that the outcomes of its legal and regulatory proceedings are not likely, either individually or in the aggregate, to have a material adverse effect on the Company's results of operations, cash flows or its consolidated financial condition. However, in the event of unexpected subsequent developments and given the inherent unpredictability of these legal and regulatory matters, the Company can provide no assurance that its assessment of any claim, dispute, regulatory examination or investigation or other legal matter will reflect the ultimate outcome and an adverse outcome in certain matters could, from time to time, have a material adverse effect on the Company's results of operations or cash flows in particular quarterly or annual periods.

In re Virtus Investment Partners, Inc. Securities Litigation; formerly Tom Cummins v. Virtus Investment Partners Inc. et al

On February 20, 2015, a putative class action complaint alleging violations of certain provisions of the federal securities laws was filed by an individual shareholder against the Company and certain of the Company's current officers (the "defendants") in the United States District Court for the Southern District of New York (the "Court"). On April 21, 2015, three plaintiffs, including the original plaintiff, filed motions to be appointed lead plaintiff and, on June 9, 2015, the Court appointed Arkansas Teachers Retirement System lead plaintiff. On August 21, 2015, plaintiff filed a Consolidated Class Action Complaint (the "Consolidated Complaint") amending the originally filed complaint, which was purportedly filed on behalf of all purchasers of the Company's common stock between January 25, 2013 and May 11, 2015 (the "Class Period"). The Consolidated Complaint alleges that, during the Class Period, the defendants disseminated materially false and misleading statements and concealed material adverse facts relating to certain funds formerly subadvised by F-Squared Investments Inc. ("F-Squared"). The Consolidated Complaint alleges claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Rule 10b-5. The plaintiff seeks to recover unspecified damages. A motion to dismiss the Consolidated Complaint was filed on behalf of the Company and the other defendants on October 21, 2015. On July 1, 2016, the Court entered an opinion and order granting in part, and denying in part, the motion to dismiss, narrowing Plaintiff's claims under Sections 10(b) and 20(a) of the Exchange Act and dismissing one of the defendants from the suit. The remaining defendants' Answer to the Consolidated Complaint was filed on August 5, 2016. The Company believes that the suit is without merit and intends to defend it vigorously. The Company believes that there is not a material loss that is probable and reasonably estimable related to this claim.

Mark Youngers v. Virtus Investment Partners, Inc. et al

On May 8, 2015, a putative class action complaint alleging violations of certain provisions of the federal securities laws was filed in the United States District Court for the Central District of California (the "District Court") by an individual who alleges he is a former shareholder of one of the Virtus mutual funds formerly subadvised by F-Squared and formerly known as the AlphaSector Funds. The complaint alleges claims against the Company, certain of the Company's officers and affiliates, and certain other parties (the "defendants"). The complaint was purportedly filed on



behalf of purchasers of the AlphaSector Funds between May 8, 2010 and December 22, 2014, inclusive (the "Class Period"). The complaint alleges that, during the Class Period, the defendants disseminated materially false and misleading statements and concealed or omitted material facts necessary to make the statements made not misleading. On June 7, 2015, a group of three individuals, including the original plaintiff, filed a motion to be appointed lead plaintiff and on July 27, 2015, the District Court appointed movants as lead plaintiff. On October 1, 2015, the plaintiffs filed a First Amended Class Action Complaint which, among other things, added a derivative claim for breach of fiduciary duty on behalf of Virtus Opportunities Trust. On October 19, 2015, the District Court entered an order transferring the action to the Southern District of New York (the "Court"). On January 4, 2016, the Plaintiffs filed a Second Amended Complaint. A motion to dismiss was filed on behalf of the Company and affiliated defendants on February 1, 2016. On July 1, 2016, the Court entered an opinion and order granting in part, and denying in part, the motion to dismiss. The Court dismissed four causes of action entirely and a fifth cause of action with respect to a portion of the Class Period. The Court also dismissed all claims against ten defendants named in the Complaint. The Court held that the Plaintiffs may pursue certain securities claims under Sections 10(b) and 20(a) of the Exchange Act and Section 12 of the

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Securities Act of 1933. The remaining defendants filed an Answer to the Second Amended Complaint on August 5, 2016. A Stipulation of Voluntary Dismissal of the claim under Section 12 of the Securities Act was filed on September 15, 2016. The defendants filed a motion to certify an interlocutory appeal of the July 1, 2016 order to the Court of Appeals for the Second Circuit on August 26, 2016. Oral argument on the motion was held on October 7, 2016. The Company believes that the suit has no basis in law or fact and intends to defend it vigorously. The Company believes that there is not a material loss that is probable and reasonably estimable related to this claim.

## Item 1A. Risk Factors

The reader should carefully consider, in connection with the other information in this report, the Company's risk factors previously reported in our 2015 Annual Report on Form 10-K. We are updating those risk factors to include the following additional risks associated with compliance related to our credit facility.

We are subject to financial covenants under our existing credit facility and failure to satisfy those covenants could result in any outstanding indebtedness becoming immediately due.

Under the Company's senior unsecured revolving credit facility (the "Credit Facility"), the Company must maintain certain financial covenants. A summary of the Credit Facility terms and financial covenants is included in this report under "Management's Discussion and Analysis of Financial Condition and Results of Operations." There can be no assurance that at all times in the future we will satisfy all such financial covenants or obtain any required waiver or amendment, in which event all outstanding indebtedness could become immediately due. This could result in a substantial reduction in the liquidity of the Company and could challenge our ability to meet future cash needs of the business.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the first nine months of 2016, we repurchased a total of 288,155 shares of our common stock pursuant to a repurchase program implemented by our Board of Directors in 2010. As of September 30, 2016, 2.7 million shares of our common stock have been authorized to be repurchased under the program, and 1,197,701 shares remain available for repurchase. Under the terms of the program, we may repurchase shares of our common stock from time to time at our discretion through open market repurchases and/or privately negotiated transactions, depending on price and prevailing market and business conditions. The program, which has no specified term, may be suspended or terminated at any time.

On June 8, 2016 the Company completed a modified "Dutch Auction" tender offer to repurchase up to \$75.0 million of its common stock. The repurchase of these shares was outside of the repurchase plan outlined above and the shares repurchased were retired. The Company paid \$47.2 million, including transaction costs, to repurchase 556,516 shares at a tender price of \$82.50 per share.

The following table sets forth information regarding our share repurchases in each month during the quarter ended September 30, 2016:

| Month                | Total number of shares repurchased | Average price paid per share (1) | Total number of shares repurchased as part of publicly announced plans or programs | Maximum number of shares that may yet be repurchased under the plans or programs (2) (3) |
|----------------------|------------------------------------|----------------------------------|--|--|
| July 1-31, 2016      | —                                  | \$ —                             | —  | 1,309,652  |
| August 1-31, 2016    | 82,311                             | \$ 89.10                         | 82,311   | 1,227,341  |
| September 1-30, 2016 | 29,640                             | \$ 90.05                         | 29,640   | 1,197,701  |

|       |         |         |
|-------|---------|---------|
| Total | 111,951 | 111,951 |
|-------|---------|---------|

(1) Average price paid per share is calculated on a settlement basis and excludes commissions.

(2) Pursuant to a program announced in the fourth quarter of 2010 and most recently expanded in October 2015. This repurchase program is not subject to an expiration date.

On October 27, 2016, the Company entered into and completed a Stock Purchase Agreement with Bank of Montreal Holdings Inc. ("BMO") to purchase 1,727,746 shares of the Company's common stock at a price of \$93.50 per share

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for a total purchase price of \$161.5 million. In connection with the purchase, the Board of Directors authorized an additional 730,045 shares to cover the incremental shares purchased beyond the remaining 1,197,701 shares available for repurchase under the Company's current share repurchase program. After the completion of this transaction there were 200,000 shares remaining for future share repurchases.

There were no unregistered sales of equity securities during the period covered by this Quarterly Report. Shares of our common stock purchased by participants in our Employee Stock Purchase Plan were delivered to participant accounts via open market purchases at fair value by the third-party administrator under the plan. We do not reserve shares for this plan or discount the purchase price of the shares.

Item 6. Exhibits

Exhibit  
Number Description

- |      |  |
|------|--|
| 10.1 | Credit Agreement dated as of September 30, 2016 among the Registrant as Borrower, the Lenders Party Thereto, PNC Bank, National Association as Syndication Agent and The Bank of New York Mellon as Administrative Agent, as Swingline Lender and as Issuing Bank (incorporated by reference to Exhibit 10.1 of the Registrant's Form 8-K, filed on October 5, 2016)   |
| 10.2 | Guarantee Agreement among the Registrant, each of the Subsidiary Guarantors Party Thereto and The Bank of New York Mellon, as Administrative Agent dated as of September 30, 2016 (incorporated by reference to Exhibit 10.2 of the Registrant's Form 8-K, filed on October 5, 2016)   |
| 31.1 | Certification of the Registrant's Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 31.2 | Certification of the Registrant's Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 32.1 | Certification of the Registrant's Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 101  | The following information formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets (Unaudited) as of September 30, 2016 and December 31, 2015, (ii) Condensed Consolidated Statements of Operations (Unaudited) for the three and nine months ended September 30, 2016 and 2015, (iii) Condensed Consolidated Statements of Comprehensive Income (Unaudited) for the three and nine months ended September 30, 2016 and 2015, (iv) Condensed Consolidated Statements of Cash Flows (Unaudited) for the nine months ended September 30, 2016 and 2015, (v) Condensed Consolidated Statements of Changes in Stockholders' Equity for the nine months ended September 30, 2016 and 2015 and (vi) Notes to Condensed Consolidated Financial Statements (Unaudited). |

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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: November 7, 2016

VIRTUS INVESTMENT PARTNERS, INC.

(Registrant)

By: /s/ Michael A. Angerthal

Michael A. Angerthal

Executive Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)