GWG Holdings, Inc.
Form 10-Q
August 14, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

S
QUARTERLY
REPORT
PURSUANT
TO SECTION
13 OR 15(d)
OF THE
SECURITIES
EXCHANGE
ACT OF 1934
For the quarterly period ended June 30, 2013

Or

o
TRANSITION
REPORT
PURSUANT
TO SECTION
13 OR 15(d)
OF THE
SECURITIES
ACT OF 1934
For the transition period from _________ to ________

Commission File Number: None

GWG HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware	26-2222607
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

220 South Sixth Street, Suite 1200
Minneapolis, MN 55402

(Address of principal executive offices, including zip code)

(612) 746-1944

(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

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

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

As of August 14, 2013, GWG Holdings, Inc. had 9,124,000 shares of common stock outstanding.

GWG HOLDINGS, INC.

Index to Form 10-Q
for the Quarter Ended June 30, 2013

PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GWG HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2013 (unaudited)	December 31, 2012
A S S E T S		
Cash and cash equivalents	$38,240,633	$27,497,044
Restricted cash	4,463,867	2,093,092
Investment in life settlements, at fair value	193,891,894	164,317,183
Other assets	7,041,894	4,040,716
TOTAL ASSETS	$243,638,288	$197,948,035
L I A B I L I T I E S & E Q U I T Y (D E F I C I T)		
LIABILITIES		
Revolving credit facility	$79,000,000	$71,000,000
Series I Secured notes payable	34,505,914	37,844,711
Renewable secured debentures	93,684,735	55,718,950
Interest payable	5,771,063	3,477,320
Accounts payable and accrued expenses	1,642,728	1,761,558
Deferred taxes, net	7,868,201	5,501,407
TOTAL LIABILITIES	222,472,641	175,303,946
CONVERTIBLE, REDEEMABLE PREFERRED STOCK		
(par value $0.001; shares authorized 40,000,000; shares issued and outstanding 3,356,787 and 3,361,076; liquidation preference of $25,176,000 and $25,208,000, respectively)	24,322,651	23,905,878
EQUITY		
Common stock (par value $0.001: shares authorized 210,000,000; shares issued and outstanding is 9,124,000 and 9,989,000 on June 30, 2013 and December 31, 2012, respectively)	9,124	9,989
Additional paid-in capital	3,253,670	6,971,844
Accumulated deficit	(6,419,798)	(8,243,622)
TOTAL EQUITY (DEFICIT)	(3,157,004)	(1,261,789)
TOTAL LIABILITIES & EQUITY (DEFICIT)	$243,638,288	$197,948,035

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

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

	Three Months Ended		Six Months Ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
REVENUE				
Gain on life settlements, net	$7,733,245	$4,867,478	$16,073,601	$5,469,246
Interest and other income	3,274,323	47,563	3,441,994	48,894
TOTAL REVENUE	11,007,568	4,915,041	19,515,595	5,518,140
EXPENSES				
Employee compensation and benefits	1,063,923	583,338	3,001,343	1,117,084
Legal and professional fees	351,910	337,179	789,200	701,403
Interest expense	4,941,942	2,379,578	9,409,157	4,817,991
Other expenses	1,091,132	703,659	2,124,277	1,262,652
TOTAL EXPENSES	7,448,907	4,003,754	15,323,977	7,899,130
INCOME (LOSS) BEFORE INCOME TAXES	3,558,661	911,287	4,191,618	(2,380,990)
INCOME TAX EXPENSE (BENEFIT)	1,801,971	609,588	2,367,794	(529,860)
NET INCOME (LOSS)	$1,756,690	$301,699	$1,823,824	$(1,851,130)
NET INCOME (LOSS) PER SHARE				
Basic	$0.18	$0.03	$0.19	$(0.19)
Diluted	$0.12	$0.03	$0.13	$(0.19)
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	9,969,989	9,989,000	9,548,205	9,989,000
Diluted	15,022,198	9,989,000	14,580,506	9,989,000

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

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

	Three Months Ended		Six Months Ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income (loss)	$1,756,690	$301,699	$1,823,824	$(1,851,130)
Adjustments to reconcile net income (loss) to net cash flows from operating activities:				
Gain on life settlements	(7,449,180)	(4,575,941)	(18,943,905)	(10,990,249)
Amortization of deferred financing and issuance costs	837,133	342,297	1,930,880	909,457
Deferred income taxes	1,802,920	609,588	2,366,794	(529,860)
Convertible, redeemable preferred stock dividends payable	178,235	294,935	261,937	421,010
(Increase) decrease in operating assets:				
Other assets	(4,164,004)	(298,060)	(3,614,132)	1,057,285
Increase (decrease) in operating liabilities:				
Accounts payable and accrued expenses	402,739	101,452	1,694,797	659,134
NET CASH FLOWS USED IN OPERATING ACTIVITIES	(6,635,467)	(3,224,030)	(14,479,805)	(10,324,353)
CASH FLOWS FROM INVESTING ACTIVITIES				
Investment in life settlements	(2,972,944)	(1,468,770)	(12,885,993)	(2,622,030)
Proceeds from settlement of life settlements	1,382,152	416,665	2,872,152	416,665
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(1,590,792)	(1,052,105)	(10,013,841)	(2,205,365)
CASH FLOWS FROM FINANCING ACTIVITIES				
Net proceeds from revolving credit facility	-	3,500,000	8,000,000	6,000,000
Proceeds from issuance of Series I Secured notes payable	-	-	-	50,000
Payments for redemption of Series I Secured notes payable	(2,423,052)	(1,918,420)	(3,930,876)	(3,468,957)
Proceeds from issuance of renewable secured debentures	18,588,867	12,695,213	42,439,661	15,757,086
Payments for redemption and issuance of renewable secured debentures	(3,033,303)	(712,587)	(5,336,571)	(712,587)
Proceeds from restricted cash	2,160,333	(3,282,199)	(2,370,775)	(57,361)
Repurchase of common stock	(3,252,400)	-	(3,252,400)	-
Issuance (redemptions) of convertible, redeemable preferred stock	(125,135)	1,350,910	(311,804)	5,787,375
Payments of issuance cost for preferred stock		(810,722)	-	(1,609,362)
NET CASH FLOWS PROVIDED BY FINANCING ACTIVITIES	11,915,310	10,822,195	35,237,235	21,746,194

NET INCREASE IN CASH AND CASH EQUIVALENTS	3,689,051	6,546,060	10,743,589	9,216,476
CASH AND CASH EQUIVALENTS				
BEGINNING OF PERIOD	34,551,582	4,548,765	27,497,044	1,878,349
END OF PERIOD	$38,240,633	$11,094,825	$38,240,633	$11,094,825

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

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

	Three Months Ended		Six Months Ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION				
Interest paid	$ 3,214,000	$ 1,313,000	$ 6,512,000	$ 2,462,000
NON-CASH INVESTING AND FINANCING ACTIVITIES				
Series I secured notes:				
Non-cash conversion of accrued interest and commissions payable to principal	$ 86,000	$ 4,000	$ 150,000	$ 8,000
Renewable secured debentures:				
Non-cash conversion of accrued interest and commission payable to principal	$ 59,000	$ 37,000	$ 100,000	$ 70,000
Convertible, redeemable preferred stock				
Non-cash conversion of dividends payable	$ 178,000	$ 138,000	$ 262,000	$ 250,000
Non-cash accretion of convertible, redeemable preferred stock to redemption value	$ 209,000	$ 435,000	$ 467,000	$ 775,000
Non-cash conversion of Series I secured notes	$ -	$ 1,130,000	$ -	$ 4,220,000
Investment in life settlements included in accounts payable	$ 262,000	$ 108,000	$ 262,000	$ 108,000

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

GWG HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(unaudited)

	Common Shares	Common Stock (par)	Additional Paid-in Capital	Accumulated Deficit	Total Equity
Balance, December 31, 2011	9,989,000	$ 9,989	$ 8,169,303	$ (7,230,723)	$ 948,569
Net income	-	-	-	(1,012,899)	(1,012,899)
Issuance of warrants to purchase common stock	-	-	380,946	-	380,946
Accretion of preferred stock to liquidation value	-	-	(1,578,405)	-	(1,578,405)
Balance, December 31, 2012	9,989,000	9,989	6,971,844	(8,243,622)	(1,261,789)
Net income				1,823,824	1,823,824
Repurchase of common stock	(865,000)	(865)	(3,251,535)		(3,252,400)
Accretion of preferred stock to liquidation value			(466,639)		(466,639)
Balance, June 30, 2013	9,124,000	$ 9,124	$ 3,253,670	$ (6,419,798)	$ (3,157,004)

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

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(1) Nature of business and summary of significant accounting policies

Nature of business - GWG Holdings, Inc. (Holdings) (previously GWG Holdings, LLC) and Subsidiaries, located in Minneapolis, Minnesota, facilitates the purchase of life insurance policies for its own investment portfolio through its wholly owned subsidiary, GWG Life Settlements, LLC (GWG Life), and its subsidiaries, GWG Trust, LLC (Trust), GWG DLP Funding II, LLC (DLP II) and its wholly owned subsidiary, GWG DLP Master Trust II (the Trust II). Holdings converted from a limited liability company into a corporation effective June 10, 2011 and as a result of this change all member units were converted into common stock. Holdings finances the acquisition of life insurance policies, and pays policy premiums, through funds available on its line of credit and the issuance of debt and equity securities. GWG Member, LLC a wholly owned subsidiary formed November 2010 to facilitate the acquisition of policies, has not commenced operations as of June 30, 2013. The entities were legally organized in Delaware and are collectively referred herein to as GWG, or the Company.

On July 11, 2011 the Company entered into a Purchase and Sale Agreement with Athena Securities Group, LTD and Athena Structured Funds PLC. Under this agreement, Holdings issued to Athena Securities Group, LTD (Athena) 989,000 shares of common stock, which was equal to 9.9% of the outstanding shares in the Company in exchange for shares equal to 9.9% of the outstanding shares in Athena Structured Funds, PLC (Athena Funds) and cash of $5,000. In accordance with Accounting Standards Codification (ASC) 505-50, the Company recorded the share-based payment transaction with Athena at the fair value of the Company’s 989,000 shares of common stock issued as it was the most reliable measurable form of consideration in this exchange the total value ascribed to the common stock issued to Athena was $3.6 million. The $5,000 cash paid by Athena, which represents the fair value of the shares of Athena Funds, is included in financing activities of the Consolidated Statement of Cash Flows.

On June 28, 2013, GWG Holdings, Inc. entered into a new Purchase and Sale Agreement with Athena Securities Limited and Athena Securities Group Limited. The June 28, 2013 agreement terminated the parties’ original Purchase and Sale Agreement dated July 11, 2011. Under the new agreement, GWG Holdings appointed Athena Securities Group Limited (i) as GWG Holdings’ exclusive representative for the offer and sale of GWG Holdings’ Renewable Secured Debentures in Ireland, and (ii) as a distributor for the offer and sale of those debentures in Europe and the Middle East, in each case until May 8, 2014. Any compensation payable to Athena Securities Group Limited will be in accordance with the compensation disclosures set forth in GWG Holdings’ prospectus for the offering filed with the SEC on dated June 4, 2013. In addition, the new agreement effected the sale by Athena Securities Limited to GWG Holdings of 865,000 shares of GWG Holdings’ common stock, and GWG Holdings’ sale back to Athena Securities Group Limited of certain shares of GWG Securities International Public Limited Company (formerly known as Athena Structured Funds PLC) originally transacted under the original July 11, 2011 agreement. The Company recorded a non-cash gain on the transaction of $3,252,000.

Basis of presentation - The condensed consolidated balance sheet as of June 30, 2013 and December 31, 2012, the condensed consolidated statements of operations for the three and six months ended June 30, 2013 and 2012, the condensed consolidated statements of cash flows for the three and six months ended June 30, 2013 and 2012, the condensed consolidated statement of changes in equity for the twelve months ended December 31, 2012 and six months ended June 30, 2013, and the related information presented in these notes, have been prepared by management in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X, without audit. To the extent that information and notes required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements are contained in or are consistent with the consolidated audited financial statements in the Company’s Form 10-K for the year ended

December 31, 2012, such information and notes have not been duplicated herein. In the opinion of management, all adjustments considered necessary for a fair presentation of results have been included. The condensed consolidated balance sheet at December 31, 2012 was derived from the audited consolidated financial statements as of that date. Operating results for the three and six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. For further information, refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

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

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Life settlements - ASC 325-30, Investments in Insurance Contracts, allows a reporting entity the election to account for its investments in life settlements using either the investment method or the fair value method. The election shall be made on an instrument-by-instrument basis and is irrevocable. Under the investment method, an investor shall recognize the initial investment at the purchase price plus all initial direct costs. Continuing costs (policy premiums and direct external costs, if any) to keep the policy in force shall be capitalized. Under the fair value method, an investor shall recognize the initial investment at the purchase price. In subsequent periods, the investor shall re-measure the investment at fair value in its entirety at each reporting period and shall recognize the change in fair value in current period income net of premiums paid. The Company uses the fair value method to account for all life settlements.

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

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

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

Deposits and initial direct costs advanced on unsettled policy acquisitions are recorded as other assets until policy ownership has been transferred to the Company. Such deposits and direct cost advances were $431,000 and $785,000 at June 30, 2013 and December 31, 2012, respectively.

Deferred financing and issuance costs – Financing costs incurred to obtain financing under the revolving credit facility, as described in note 6, have been capitalized and are amortized using the straight-line method (which approximated the interest method) over the term of the revolving credit facility. Amortization of deferred financing costs was $89,000 and $58,000 for the three months ended June 30, 2013 and 2012, respectively, and $276,000 and $116,000 for the six months ended June 30, 2013 and 2012, respectively. The future amortization is $179,000 and $358,000 for the six months ending December 31, 2013 and the year ending December 31, 2014, respectively. The Series I Secured notes payable, as described in note 7, are reported net of issuance costs, sales commissions and other direct expenses, which are amortized using the interest method over the term of each respective borrowing. The Renewable Secured Debentures, as described in note 8, are reported net of issuance costs, sales commissions and other direct expenses, which are amortized using the interest method over the term of each respective borrowing. The Series A preferred stock, as described in note 9, is reported net of issuance costs, sales commissions, including the fair value of warrants issued, and other direct expenses, which are amortized using the interest method as interest expense over the three-year redemption period.

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

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

Recently adopted pronouncements - In May 2011, the FASB issued ASU No. 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS", which amends disclosure requirements related to categorization within the fair value hierarchy. This update results in common principles and requirements for measuring fair value and disclosing information about fair value measurements in accordance with GAAP and International Financial Reporting Standards. The guidance became effective for the annual period beginning January 1, 2012. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

Other pronouncements issued by the FASB or other authoritative accounting standards groups with future effective dates are either not applicable or are not expected to be significant to the Company.

(2) Restrictions on cash

The Company is required by its lenders to maintain collection and escrow accounts. These accounts are used to pay annual premiums of insurance policies, pay interest and other charges under the revolving credit facility, and collect policy benefits. DZ Bank AG, as agent for Autobahn Funding Company, LLC, the lender for the revolving credit facility as described in note 6, authorizes the disbursements from these accounts. At June 30, 2013 and December 31, 2012 there was a balance of $4,464,000, and $2,093,000, respectively, maintained in these restricted cash accounts.

(3) Investment in life insurance policies

The life insurance policies (Level 3 fair value measurements) are valued based on unobservable inputs that are significant to the overall fair value measurement. Changes in the fair value of these instruments are recorded in gain or loss on life insurance policies in the consolidated statements of operations (net of the cash premiums paid on the policies). The fair value is determined on a discounted cash flow basis that incorporates life expectancy assumptions. Life expectancy reports have been obtained from widely accepted life expectancy providers. The discount rate incorporates current information about market interest rates, the credit exposure to the insurance company that issued the life insurance policy and our estimate of the risk premium an investor in the policy would require. As a result of management's analysis, discount rates of 11.84% and 12.08% were applied to the portfolio as of June 30, 2013 and December 31, 2012, respectively.

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

	As of June 30, 2013			As of December 31, 2012		
Years Ending December 31,	Number of Contracts	Estimated Fair Value	Face Value	Number of Contracts	Estimated Fair Value	Face Value
2013	-	$ -	$ -	-	$ -	$ -
2014	-	-	-	-	-	-

2015	2	1,239,000	2,000,000	2	1,163,000	2,000,000
2016	10	7,059,000	12,729,000	13	11,608,000	22,229,000
2017	18	25,099,000	56,173,000	17	21,155,000	53,439,000
2018	31	32,382,000	77,629,000	31	28,252,000	75,668,000
2019	40	34,198,000	99,668,000	35	26,947,000	84,579,000
Thereafter	140	93,915,000	402,456,000	113	75,192,000	334,331,000
Totals	241	$ 193,892,000	$ 650,655,000	211	$ 164,317,000	$ 572,246,000

The Company recognized death benefits of $6,600,000 and $4,500,000 during the three-month periods ended June 30, 2013 and 2012, respectively, related to policies with a carrying value of $1,382,000 and $417,000, respectively. The Company recorded realized gains of $5,218,000 and $4,083,000 on such policies. The Company recognized death benefits of $10,600,000 and $4,500,000 during the six-month periods ended June 30, 2013 and 2012, respectively, related to policies with a carrying value of $2,872,000 and $417,000, respectively. The Company recorded realized gains of $7,728,000 and $4,083,000 on such policies. Subsequent to June 30, 2013, two policies with an aggregate death benefit of $2,500,000 have matured.

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Reconciliation of gain on life settlements:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Change in fair value	$7,449,000	$4,576,000	$18,944,000	$9,367,000
Premiums and other annual fees	(4,934,000)	(3,792,000)	(10,598,000)	(7,981,000)
Policy maturities	5,218,000	4,083,000	7,728,000	4,083,000
Gain on life settlements, net	$7,733,000	$4,867,000	$16,074,000	$5,469,000

The estimated expected premium payments to maintain the above life insurance policies in force for the next five years, assuming no mortalities, are as follows:

Years Ending December 31,	
Six months ending December 31, 2013	$10,272,000
2014	21,206,000
2015	22,986,000
2016	25,222,000
2017	27,757,000
	$107,443,000

Management anticipates funding the estimated premium payments as noted above with proceeds from the DZ Bank revolving credit facility and through additional debt and equity financing as well as from cash proceeds from maturities of life insurance policies. The proceeds of these capital sources are also intended to be used for the purchase, financing, and maintenance of additional life insurance policies.

(4) Fair value definition and hierarchy

ASC 820 establishes a hierarchical disclosure framework which prioritizes and ranks the level of market price observability used in measuring assets and liabilities at fair value. Market price observability is affected by a number of factors, including the type of investment, the characteristics specific to the investment and the state of the marketplace including the existence and transparency of transactions between market participants. Assets and liabilities with readily available active quoted prices or for which fair value can be measured from actively quoted prices in an orderly market generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value. ASC 820 establishes a three-level valuation hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company’s assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the “exit price”) in an orderly transaction between market participants at the measurement date.

The hierarchy is broken down into three levels based on the observability of inputs as follows:

Level 1 - Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Level 2 - Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

The availability of observable inputs can vary by types of assets and liabilities and is affected by a wide variety of factors, including, for example, whether an instrument is established in the marketplace, the liquidity of markets and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by management in determining fair value is greatest for assets and liabilities categorized in Level 3.

Level 3 Valuation Process

The estimated fair value of the Company's life settlements are determined on a quarterly basis by the Company's portfolio management committee, taking into consideration changes in discount rate assumptions, estimated premium payments and life expectancy assumptions, as well as any changes in economic and other relevant conditions. These inputs are then used to estimate the discounted cash flows using the MAPS probabilistic portfolio pricing model, which estimates the cash flows using various probabilities and scenarios. The valuation process includes a review by senior management as of each valuation date. Management will also engage a third party expert to independently test the accuracy of the valuations using the inputs provided by management.

Life insurance policies represent financial instruments recorded at fair value on a recurring basis. The following table reconciles the beginning and ending fair value of the Company's Level 3 investments in life insurance policies for the three and six month periods ending June 30, as follows:

	Three month ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Beginning balance	$185,020,000	$128,112,000	$164,317,000	$122,169,000
Purchases	2,805,000	1,576,000	13,503,000	2,728,000
Maturities (cash in excess of carrying value)	(1,382,000)	(416,000)	(2,872,000)	(416,000)
Net change in fair value	7,449,000	4,576,000	18,944,000	9,367,000
Ending balance (June 30)	$193,892,000	$133,848,000	$193,892,000	$133,848,000

The fair value of a portfolio of life insurance policies is based on information available to the Company at the reporting date. Fair value is based upon a discounted cash flow model that incorporates life expectancy assumptions. Life expectancy reports are obtained from independent and third-party widely accepted life expectancy providers at policy acquisition. The life expectancy values of each policy holder, as determined at policy acquisition, are rolled down monthly for the passage of time by the MAPS actuarial software the Company uses for ongoing valuation of its portfolio of life insurance policies. The discount rate incorporates current information about market interest rates, the credit exposure to the insurance company that issued the life insurance policy and management's estimate of the risk premium an investor in the portfolio of life insurance policies would require.

On January 22, 2013, one of the independent medical actuarial underwriting firms we utilize, 21st Services, announced advancements in its underwriting methodology, resulting in revised estimated life expectancy mortality tables for life settlement transactions. We have been advised by 21st Services that the changes are very granular and relate to both specific medical conditions and lifestyles of insureds. These changes are the result of the application of additional medical information that has been gathered by 21st Services over a period of time, and which has now been applied to the inputs and methodologies used to develop the actuarial life expectancies. While we do not believe these revised methodologies indicate the previous estimated life expectancies were inaccurate, we believe the revised methodologies provide additional information that should be considered in updating our estimate of the life expectancies of the insureds within our portfolio of life settlement contracts as of June 30, 2013 and December 31, 2012. Based upon our evaluation and analysis of data made available by 21st Services, as well as information regarding the insureds within our portfolio, we have estimated the impact of the changes in 21st Services' methodologies for determining life expectancies on a policy-by-policy basis within our portfolio and applied such changes to the life expectancy inputs used to estimate fair value. We have adjusted the original life expectancies provided by 21st Services based on four factors, the impact of each analyzed individually for each insured in the GWG portfolio. The four factors are gender, anti-selection, age, and primary impairment. While the analysis and adjustments were applied on an individual policy basis, the result was an average overall increase in the original life expectancy estimates of 8.67%. We have a standard practice of obtaining two third-party life expectancy estimates for each policy in our portfolio. As a result, the effective change in life expectancy on the portfolio was an average of approximately 4.33%, which resulted in an aggregate decrease in the fair value of our life settlements portfolio of $12.4 million as of December 31, 2012. Life expectancy reports by their very nature are estimates. Due to the estimating changes made by 21st Services, and because refinement in estimating methods is on-going, we plan to obtain new life expectancy reports for all policies purchased where we used a life expectancy report from 21st Services. As part of our on-going process to maintain current information regarding the insureds included in our portfolio, we are updating the life expectancy estimates in our portfolio valuation process as new information becomes available.

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

The fair value of life insurance policies is estimated using present value calculations of estimated cash flows based on the data specific to each individual life insurance policy. Estimated future policy premium payments are calculated based on the terms of the policy and the premium payment history. The following summarizes the unobservable inputs utilized in estimating the fair value of the portfolio of life insurance policies:

	As of June 30, 2013	As of December 31, 2012
Weighted average age of insured	81.7	81.3
Weighted average life expectancy, months*	90.4	91.6
Average face amount per policy	$ 2,699,814	$ 2,712,063
Discount rate	11.84%	12.08%

* Standard life expectancy as adjusted for insured's specific circumstances.

These assumptions are, by their nature, inherently uncertain and the effect of changes in estimates may be significant. The techniques used in estimating the present value of estimated cash flows are derived from valuation techniques generally used in the industry that include inputs for the asset that are not based on observable market data. The extent to which the fair value could reasonable vary in the near term has been quantified by evaluating the effect of changes in significant underlying assumptions used to estimate the fair value. If the life expectancies were increased or decreased by 4 and 8 months on each outstanding policy and the discount factors were increased or decreased by 1% and 2%, while all other variables are held constant, the fair value of the investment in life insurance policies would increase or (decrease) by the amounts summarized below:

	Change in life expectancy			
	plus 8 months	minus 8 months	plus 4 months	minus 4 months
June 30, 2013	$ (28,173,000)	$ 29,545,000	$ (14,258,000)	$ 14,601,000
December 31, 2012	$ (24,072,000)	$ 25,268,000	$ (12,185,000)	$ 12,484,000

	Change in discount rate			
	plus 2%	minus 2%	plus 1%	minus 1%
June 30, 2013	$ (19,390,000)	$ 23,002,000	$ (10,098,000)	$ 10,998,000
December 31, 2012	$ (16,811,000)	$ 19,978,000	$ (8,759,000)	$ 9,547,000

Carrying value of receivables, prepaid expenses, accounts payable and accrued expenses approximate fair value due to their short-term maturities and low credit risk. The estimated fair value of the Company's Series I Secured notes payable is approximately $35,703,000 based on a weighted-average market interest rate of 7.45% based on an income approach. The Company began issuing Renewable Secured Debentures in the first quarter of 2012. The current interest rates on the Renewable Secured Debentures approximate market rates. The carrying value of the Renewable Secured Debentures approximates fair value. The carrying value of the revolving credit facility reflects interest charged at the commercial paper rate plus an applicable margin. The margin represents our credit risk, and the strength of the portfolio of life insurance policies collateralizing the debt. The overall rate reflects market, and the carrying value of the revolver approximates fair value. All of the financial instruments are level 3 fair value measurements.

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

The Company has issued warrants to purchase common stock in connection with the issuance of its convertible, redeemable preferred stock. Warrants were determined by the Company as permanent equity. The fair value measurements associated with the warrants, measured at issuance represent level 3 instruments.

Month issued	Warrants issued	Fair value per share	Risk free rate	Volatility	Term
December 2011	137,874	$ 0.11	0.42%	25.25%	3 years
March 2012	76,260	$ 0.26	0.38%	36.20%	3 years
June 2012	323,681	$ 0.58	0.41%	47.36%	3 years
July 2012	289,093	$ 0.58	0.41%	47.36%	3 years
September 2012	5,000	$ 0.36	0.31%	40.49%	3 years
	831,908				

Volatility is based upon the weekly percentage change in the stock price of selected comparable insurance companies. In June 2012, we evaluated the comparable companies used, and made certain changes to those used. The percentage change is calculated on the average price of those selected stocks at the weekly close of business for the year preceding the balance sheet date. We compare annual volatility based on this weekly information.

(5) Notes receivable from related parties

As of June 30, 2013 and December 31, 2012, the Company had receivables totaling $5,000,000 due from an affiliate, Opportunity Finance, LLC, which were fully reserved. Opportunity Finance ceased operations in 2008.

(6) Credit facilities

Revolving credit facility – Autobahn Funding Company LLC

On July 15, 2008, DLP II and United Lending entered into a revolving credit facility pursuant to a Credit and Security Agreement (Agreement) with Autobahn Funding Company LLC (Autobahn), providing the Company with a maximum borrowing amount of $100,000,000. Autobahn is a commercial paper conduit that issues commercial paper to investors in order to provide funding to DLP II and United Lending. DZ Bank AG acts as the agent for Autobahn. The original Agreement was to expire on July 15, 2013. On January 29, 2013, Holdings, together with GWG Life and DLP II, entered into an Amended and Restated Credit and Security Agreement with Autobahn, extending the facility expiration date to December 31, 2014, and removing United Lending as a party to the amended and restated Agreement. The amount outstanding under this facility as of June 30, 2013 and December 31, 2012, was $79,000,000 and $71,000,000, respectively.

The Agreement requires DLP II to pay, on a monthly basis, interest at the commercial paper rate plus an applicable margin, as defined in the Agreement. The effective rate was 6.27% and 2.02% at June 30, 2013 and December 31, 2012, respectively. The weighted-average effective interest rate was 6.26% and 2.12% (excluding the unused line fee) for the three months ended June 30, 2013 and 2012, respectively, and 6.06% and 2.19% for the six months ended June 30, 2013 and 2012, respectively. The Agreement also requires payment of an unused line fee on the unfunded amount under the revolving credit facility. The note is secured by substantially all of DLP II assets, which consist primarily of life settlement policies.

The Agreement has certain financial and nonfinancial covenants. The Company was in compliance with these covenants at June 30, 2013 and December 31, 2012. The Agreement generally prohibits the Company from:

- changing its corporate name, offices, and jurisdiction of incorporation
- changing any deposit accounts or payment instructions to insurers;
- changing any operating policies and practices such that it would be reasonably likely to adversely affect the collectability of any asset in any material respect;
- merging or consolidating with, or selling all or substantially all of its assets to, any third party;
- selling any collateral or creating or permitting to exist any adverse claim upon any collateral;
- engaging in any other business or activity than that contemplated by the Agreement;
- incurring or guaranteeing any debt for borrowed money;
- amending the Company's certificate of incorporation or bylaws, making any loans or advances to, investments in, or paying any dividends to, any person unless both before and after any such loan, advance, investment or dividend there exists no actual event of default, potential event of default or termination event;

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

removing an independent director on the board of directors except for cause or with the consent of the lender; or

making payment on or issuing any subsidiary secured notes or debentures, or amending any agreements respecting such notes or debentures, if an event of default, potential event of default or termination event exists or would arise from any such action.

In addition, the Company has agreed to maintain (i) a positive consolidated net income (as defined and calculated under the Agreement) for each complete fiscal year and (ii) a tangible net worth (again, as defined and calculated under the Agreement) of not less than $15 million, and (iii) maintain a borrowing base surplus or cash cushion sufficient to pay three to twelve months (increasing throughout 2013) of premiums and facility fees.

Consolidated net income and tangible net worth as of and for the 4 quarter period ended June 30, 2013, as calculated under the agreement, were $5,905,000 and $44,233,000, respectively.

Advances under the Agreement are subject to a borrowing base formula, which limits the availability of advances on the borrowing base calculation based on attributes of policies pledged to the facility. Over-concentration of policies by insurance carrier, over-concentration of policies by insurance carriers with ratings below a AA- rating, and the premiums and facility fees reserve are the three primary factors with the potential of limiting availability of funds on the facility. Total funds available for additional borrowings under the borrowing base formula criteria at June 30, 2013 and December 31, 2012, were $667,000 and $15,043,000 respectively.

On July 15, 2008, Holdings delivered a performance guaranty in favor of Autobahn pursuant to which it guaranteed the obligations of GWG Life, in its capacity as the seller and master servicer, under the Credit and Security Agreement and related documents. On January 29, 2013 and in connection with the Amended and Restated Credit and Security Agreement, Holdings delivered a reaffirmation of its performance guaranty. The obligations of Holdings under the performance guaranty and subsequent reaffirmation do not extend to the principal and interest owed by DLP II as the borrower under the credit facility.

(7) Series I Secured notes payable

Series I Secured notes payable have been issued in conjunction with the GWG Series I Secured notes private placement memorandum dated August 25, 2009 (last revised November 15, 2010). On June 14, 2011 the Company closed the offering to additional investors, however, existing investors may elect to continue advancing amounts outstanding upon maturity subject to the Company's option. Series I Secured notes have maturity dates ranging from six months to seven years with fixed interest rates varying from 5.65% to 9.55% depending on the term of the note. Interest is payable monthly, quarterly, annually or at maturity depending on the terms of the note. At June 30, 2013 and December 31, 2012 the weighted-average interest rates of Series I Secured notes were 8.27%, and 8.22% respectively. The notes are secured by assets of GWG Life. The principal amount outstanding under these Series I Secured notes was $35,299,000 and $38,570,000 at June 30, 2013, and December 31, 2012, respectively. The difference between the amount outstanding on the Series I Secured notes and the carrying amount on the consolidated balance sheet is due to netting of unamortized deferred issuance costs. Overall, interest expense includes amortization of deferred financing and issuance costs of $161,000 and $217,000 for the three and six months ended June 30, 2013, respectively, and $237,000 and $746,000 for the three and six months ended June 30, 2012, respectively. Future expected amortization of deferred financing costs is $793,000 over the next six years.

On November 15, 2010, the holders of a majority of the membership interests in the company (then a limited liability company), Messrs. Jon R. Sabes and Steven F. Sabes, pledged their ownership interests in the Company to the Series I Trust as security for advances under the Series I Trust arrangement.

The use of proceeds from the issuances of Series I Secured notes was limited to the following: (1) payment of commissions of Series I Secured note sales, (2) purchase life insurance policies, (3) pay premiums of life insurance policies, (4) pay principal and interest to Senior Liquidity Provider (DZ Bank), (5) pay portfolio or note operating fees or costs, (6) pay trustee (Wells Fargo Bank, N.A.), (7) pay servicer and collateral fees, (8) pay principal and interest on Series I Secured notes, (9) make distributions to equity holders for tax liability related to portfolio, (10) purchase interest rate caps, swaps, or hedging instruments, (11) pay GWG Series I Trustee fees, and (12) pay offering expenses.

On November 1, 2011, GWG entered into a Third Amended and Restated Note Issuance and Security Agreement with Lord Securities Corporation after receiving majority approval from the holders of Series I Secured notes. Among other things, the amended and restated agreement modified the use of proceeds and certain provisions relating to the distribution of collections and subordination of cash flow. Under the amended and restated agreement, GWG is no longer restricted as to its use of proceeds or subject to restrictions on certain distributions of collections and subordination of cash flows.

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Future contractual maturities of Series I Secured notes payable at June 30, 2013 are as follows:

Years Ending December 31,	
Six months ending December 31, 2013	$9,358,000
2014	12,561,000
2015	6,675,000
2016	1,802,000
2017	4,085,000
Thereafter	818,000
	$35,299,000

(8) Renewable secured debentures

The Company has registered with the Securities and Exchange Commission, effective January 2012, the offer and sale of $250,000,000 of secured debentures. Renewable Secured Debentures have maturity dates ranging from six months to seven years with fixed interest rates varying from 4.75% to 9.50% depending on the term of the note. Interest is payable monthly, annually or at maturity depending on the terms of the debenture. At June 30, 2013 and December 31, 2012, the weighted-average interest rate of Renewable Secured Debentures was 7.58% and 7.65%, respectively. The debentures are secured by assets of GWG Life and GWG Holdings. The amount outstanding under these Renewable Secured Debentures was $95,858,000 and $57,609,000 at June 30, 2013 and December 31, 2012, respectively. The difference between the amount outstanding on the Renewable Secured Debentures and the carrying amount on the consolidated balance sheets is due to netting of unamortized deferred issuance costs and cash receipts for new issuances in process. Amortization of deferred issuance costs was $344,000 and $622,000 for the three and six months ended June 30, 2013, respectively, and $44,000 and $47,000 for the three and six months ended June 30, 2012, respectively. Future expected amortization of deferred financing costs is $4,114,000. Subsequent to June 30, 2013, the Company has issued approximately an additional $10,300,000 in principal amount of these secured debentures.

The use of proceeds from the issuances of Renewable Secured Debentures is limited to the following: (1) payment of commissions on sales of Renewable Secured Debentures, (2) payment of offering expenses, (3) purchase of life insurance policies, (4) Payment of premiums on life insurance policies, (5) payment of principal and interest on Renewable Secured Debentures, (6) payment of portfolio operations expenses, and (7) for general working capital.

Future contractual maturities of Renewable Secured Debentures at June 30, 2013 are as follows:

Years Ending December 31,	
Six months ending December 31, 2013	$11,839,000
2014	15,272,000
2015	30,085,000
2016	16,359,000
2017	6,529,000
Thereafter	15,774,000
	$95,858,000

The Company entered into an indenture effective October 19, 2011 with Holdings as obligor, GWG Life as guarantor, and Bank of Utah as trustee for the benefit of the debenture holders. The indenture has certain financial and nonfinancial covenants. The Company was in compliance with these covenants at June 30, 2013 and December 31, 2012.

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(9) Convertible, redeemable preferred stock

The Company began offering 3,333,333 shares of convertible redeemable preferred stock (Series A preferred stock) for sale to accredited investors in a private placement on July 31, 2011. The offering of Series A preferred stock concluded on September 2, 2012 and resulted in 3,278,000 shares being issued for gross consideration of $24,582,000. As of June 30, 2013, 121,000 shares have been issued as a result of conversion of $846,000 in dividends into shares of Series A preferred stock. The Series A preferred stock was sold at an offering price of $7.50 per share. Series A preferred stock has a preferred yield of 10% per annum, and each share has the right to convert into 1.5 shares of the Company's common stock. The Company may elect to automatically convert the Series A preferred stock to common stock as described below. Series A preferred shareholders also received three-year warrants to purchase, at an exercise price per share of $6.25, one share of common stock for every 20 shares of Series A preferred stock purchased. The warrants are exercisable immediately. In the Certificate of Designations for the Series A preferred stock dated July 31, 2011, the Company has agreed to permit preferred shareholders to sell their shares back to the Company for the stated value of $7.50 per share, plus accrued dividends, according to the following schedule:

Up to 33% of the holder's unredeemed shares one year after issuance:
Up to 66% of the holder's unredeemed shares two years after issuance; and
Up to 100% of the holder's unredeemed shares three years after issuance.

The Company's obligation to redeem Series A preferred shares will terminate upon the Company completing a registration of its common stock with the SEC. The Company may redeem the Series A preferred shares at a price equal to 110% of their liquidation preference ($7.50 per share) at any time after December 15, 2012.

At the election of the Company, the Series A preferred shares may be automatically converted into the common stock of the Company in the event of either (1) a registered offering of the Company's common stock with the SEC aggregating gross proceeds of at least $5.0 million at a price equal to or greater than $5.50 per share of common stock, or (2) the consent of shareholders holding at least a majority of the then-outstanding shares of Series A preferred stock. As of June 30, 2013, the Company had issued 3,400,000 preferred shares resulting in gross consideration of $25,437,000 (including cash proceeds, conversion of Series I Secured notes and accrued interest on Series I notes, and conversion of preferred dividends payable). In 2013, the Company redeemed 43,000 shares valued at $322,000 resulting in 3,357,000 shares outstanding with the gross value of $25,115,000. The Company incurred Series A preferred stock issuance costs of $2,838,000, of which $2,045,000 was amortized to additional paid in capital as of June 30, 2013, resulting in a carrying amount of $24,323,000.

The Company determined that the grant date fair value of the outstanding warrants attached to the Series A preferred stock was $395,000 for warrants issued through June 30, 2013. The Company may redeem outstanding warrants prior to their expiration, at a price of $0.01 per share upon 30 days written notice to the investors at any time after (i) the Company has completed a registration of its common stock with the SEC and (ii) the volume of weighted average sale price per share of common stock equals or exceeds $7.00 per share for ten consecutive trading days ending on the third business day prior to proper notice of such redemption. Total warrants outstanding as of June 30, 2013, were 831,909 with a weighted average remaining life of 1.85 years. Total warrants outstanding at December 31, 2012, were 831,909 with a weighted average remaining life of 2.34 years.

Dividends on the Series A preferred stock may be paid in either cash or additional shares of Series A preferred stock at the election of the holder and approval of the Company. The dividends are reported as an expense and included in the caption interest expense in the consolidated statements of operations.

The Company declared and accrued dividends of $628,000 and $573,000 during the three months ended June 30, 2013 and 2012, respectively, and $1,263,000 and $990,000 during the six months ended June 30, 2013 and 2012, respectively, pursuant to a board resolution declaring the dividend. 25,000 and 20,000 shares of Series A preferred stock were issued in lieu of cash dividends in the three month periods ended June 30, 2013 and 2012, and 37,000 and 35,000 shares of Series A preferred stock were issued in lieu of cash dividends in the six month periods ended June 30, 2013 and 2012 respectively. The shares issued in lieu of cash dividends were issued at $7.00 per share. As of June 30, 2013, Holdings has $628,000 of accrued preferred dividends which were paid or converted to shares of Series A preferred stock on July 15, 2013.

(10) Income taxes

For the three and six months ended June 30, 2013, the Company recorded income tax expense of $1,802,000 and $2,368,000, or 50.6% and 56.5%, respectively, of income before taxes, compared to the recognition of an income tax expense of $610,000, or 66.9% for the three months ended June 30, 2012 and recognizing an income tax benefit of $530,000, or 22.3% for the six months ended June 30, 2012. The primary differences between the Company’s June 30, 2013 effective tax rate and the statutory federal rate are the accrual of preferred stock dividend expense, state taxes, and other non-deductible expenses.

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

The most significant temporary differences between GAAP net income and taxable net income are the treatment of interest costs with respect to the acquisition of the life insurance policies and revenue recognition with respect to the mark-to-market of life insurance portfolio.

(11) Earnings per share and proforma information

The Company began issuing Series A preferred stock September, 1, 2011, as described in note 9. The Series A preferred stock is dilutive to the earnings per share calculation at June 30, 2013 and 2012. The Company has also issued warrants to purchase common stock in conjunction with the sale of convertible preferred stock, as discussed in note 9. The warrants are anti-dilutive at June 30, 2013 and 2012 and have not been included in the fully diluted earnings per share calculation.

(12) Commitments

The Company entered into an office lease with U.S. Bank National Association as the landlord. The lease was effective April 22, 2012 with a term through August 31, 2015. The lease is for 8,881 square feet of office space located at 220 South Sixth Street, Minneapolis, Minnesota. The Company is obligated to pay base rent plus common area maintenance and a share of the building operating costs. Rent expenses under this and previous agreements were $98,000 and $73,000 during the six-month periods ended June 30, 2013 and 2012, respectively. Rent expenses under this and previous agreements were $50,000 and $36,000 during the three-month periods ended June 30, 2013 and 2012, respectively. Minimum lease payments under the lease agreement effective April 22, 2012 are as follows:

Six months ending December 31, 2013	$49,000
2014	104,000
2015	70,000
Total	$223,000

(13) Contingencies

Litigation - In the normal course of business, the Company is involved in various legal proceedings. In the opinion of management, any liability resulting from such proceedings would not have a material adverse effect on the Company’s financial position, results of operations or cash flows.

Opportunity Finance, LLC, owned by Jon Sabes and Steven Sabes, is subject to litigation clawback claims by the bankruptcy trustee for third-party matters for payments that may have been deemed preference payments. In addition, Jon Sabes and Steven Sabes are subject to litigation clawback claims by the bankruptcy trustee for third-party matters for payments received from Opportunity Finance that may have been deemed preference payments. If the parties are unsuccessful in defending against these claims, their equity ownership in the Company may be sold or transferred to other parties to satisfy such claims. In addition, the Company loaned $1,000,000 to Opportunity Finance, LLC in 2006, and was repaid in full plus interest of $177,000. This investment amount may also be subject to clawback claims by the bankruptcy court. These matters may also distract management and reduce the time and attention that they are able to devote to the Company’s operations.

(14) Guarantees of secured debentures

Holdings has registered with the Securities and Exchange Commission the offer and sale $250,000,000 of secured debentures as described in note 8. The secured debentures are secured by the assets of Holdings as described in note 8 and a pledge of all the common stock by the largest shareholders. Obligations under the debentures are guaranteed by Holding's subsidiary GWG Life. This guarantee involves the grant of a security interest in all the assets of GWG Life. GWG Life is a wholly owned subsidiary of Holdings and the payment of principal and interest on the secured debentures is fully and unconditionally guaranteed by GWG Life. Substantially all of the Company's life insurance policies are held by DLP II, a wholly owned subsidiary of GWG Life. The policies held by DLP II are not collateral for the debenture obligations as such policies are collateral for the credit facility.

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

The consolidating financial statements are presented in lieu of separate financial statements and other related disclosures of the subsidiary guarantors and issuer because management does not believe that separate financial statements and related disclosures would be material to investors. There are currently no significant restrictions on the ability of Holdings or GWG Life, the guarantor subsidiary, to obtain funds from its subsidiaries by dividend or loan, except as follows. DLP II is a borrower under a credit agreement with Autobahn, with DZ Bank AG as agent, as described in note 6. The significant majority of insurance policies owned by the Company are subject to a collateral arrangement with DZ Bank AG described in notes 3 and 6. Under this arrangement, collection and escrow accounts are used to fund premiums of the insurance policies and to pay interest and other charges under the revolving credit facility. DZ Bank AG and Autobahn must authorize all disbursements from these accounts, including any distributions to GWG Life. Distributions are limited to an amount that would result in the borrowers (GWG DLP Funding II, LLC, GWG Life Settlements, LLC, and GWG Holdings, Inc.) realizing an annualized rate of return on the equity funded amount for such assets of not more than 18%, as determined by DZ Bank AG. After such amount is reached, the credit agreement requires that excess funds be used for repayments of borrowings before any additional distributions may be made.

The following represents consolidating financial information as of June 30, 2013 and December 31, 2012, with respect to the financial position, and for the three and six months ended June 30, 2013 and 2012 with respect to results of operations and cash flows of Holdings and its subsidiaries. The parent column presents the financial information of Holdings, the primary obligor of the secured debentures. The guarantor subsidiary column presents the financial information of GWG Life, the guarantor subsidiary of the secured debentures, presenting its investment in DLP II and Trust under the equity method. The non-guarantor subsidiaries column presents the financial information of all non-guarantor subsidiaries including DLP II and Trust.

Condensed Consolidating Balance Sheets

June 30, 2013	Parent	Guarantor Sub	Non-Guarantor Sub	Eliminations	Consolidated
A S S E T S					
Cash and cash equivalents	$ 36,989,169	$ 1,251,464	$ -	$ -	$ 38,240,633
Restricted cash	-	2,501,500	1,962,367	-	4,463,867
Investment in life settlements, at fair value	-	-	193,891,894	-	193,891,894
Other assets	263,555	328,363	6,449,976	-	7,041,894
Investment in subsidiaries	88,702,942	122,020,978	-	(210,723,920)	-
TOTAL ASSETS	$ 125,955,666	$ 126,102,305	$ 202,304,237	$ (210,723,920)	$ 243,638,288
L I A B I L I T I E S & S T O C K H O L D E R S ' E Q U I T Y (D E F I C I T)					
LIABILITIES					
Revolving credit facility	$ -	$ -	$ 79,000,000	$ -	$ 79,000,000
Series I Secured notes payable	-	34,505,914	-	-	34,505,914
Secured renewable debentures	93,684,735	-	-		93,684,735

Interest payable	2,577,524	2,686,747	506,792	-	5,771,063
Accounts payable and accrued expenses	659,559	206,702	776,467	-	1,642,728
Deferred taxes, net	7,868,201	-	-	-	7,868,201
TOTAL LIABILITIES	104,790,019	37,399,363	80,283,259	-	222,472,641
CONVERTIBLE, REDEEMABLE PREFERRED STOCK	24,322,651	-	-	-	24,322,651
EQUITY (DEFICIT)					
Member capital	-	88,702,942	122,020,978	(210,723,920)	-
Common stock	9,124	-	-	-	9,124
Additional paid-in capital	3,253,670	-	-	-	3,253,670
Accumulated deficit	(6,419,798)	-	-	-	(6,419,798)
TOTAL EQUITY (DEFICIT)	(3,157,004)	88,702,942	122,020,978	(210,723,920)	(3,157,004)
TOTAL LIABILITIES AND EQUITY (DEFICIT)	$ 125,955,666	$ 126,102,305	$ 202,304,237	$ (210,723,920)	$ 243,638,288

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Condensed Consolidating Balance Sheets (continued)

December 31, 2012	Parent	Guarantor Sub	Non-Guarantor Sub	Eliminations	Consolidated
A S S E T S					
Cash and cash equivalents	$ 25,035,579	$ 2,461,465	$ -	$ -	$ 27,497,044
Restricted cash	-	1,748,700	344,392		2,093,092
Investment in life settlements, at fair value	-	-	164,317,183	-	164,317,183
Other assets	96,994	211,592	3,732,130	-	4,040,716
Investment in subsidiaries	60,608,585	96,914,613	-	(157,523,198)	-
TOTAL ASSETS	$ 85,741,158	$ 101,336,370	$ 168,393,705	$ (157,523,198)	$ 197,948,035
L I A B I L I T I E S & S T O C K H O L D E R S ' E Q U I T Y (D E F I C I T)					
LIABILITIES					
Revolving credit facility	$ -	$ -	$ 71,000,000	$ -	$ 71,000,000
Series I Secured notes payable	-	37,844,711	-	-	37,844,711
Secured renewable debentures	55,718,950	-	-		55,718,950
Interest payable	905,017	2,444,097	128,206	-	3,477,320
Accounts payable and accrued expenses	971,695	490,497	302,366	-	1,761,558
Deferred taxes, net	5,501,407	-	-	-	5,501,407
TOTAL LIABILITIES	63,097,069	40,776,305	71,430,572	-	175,303,946
CONVERTIBLE, REDEEMABLE PREFERRED STOCK	23,905,878	-	-	-	23,905,878
EQUITY (DEFICIT)					
Member capital	-	60,560,065	96,963,133	(157,523,198)	-
Common stock	9,989	-	-	-	9,989
Additional paid-in capital	6,971,844	-	-	-	6,971,844
Accumulated deficit	(8,243,622)	-	-	-	(8,243,622)
TOTAL EQUITY (DEFICIT)	(1,261,789)	60,560,065	96,963,133	(157,523,198)	(1,261,789)
TOTAL LIABILITIES AND EQUITY (DEFICIT)	$ 85,741,158	$ 101,336,370	$ 168,393,705	$ (157,523,198)	$ 197,948,035

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Condensed Consolidating Statements of Operations

For the six months ended June 30, 2013	Parent	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUE					
Contract servicing fees	$-	$1,814,202	$ -	$(1,814,202)	$ -
Gain on life settlements, net	-	-	16,073,601	-	16,073,601
Interest and other income	3,267,454	977,855	37,620	(840,935)	3,441,994
TOTAL REVENUE	3,267,454	2,792,057	16,111,221	(2,655,137)	19,515,595
EXPENSES					
Origination and servicing fees	-	-	1,814,202	(1,814,202)	-
Employee compensation and benefits	2,213,056	788,287	-	-	3,001,343
Legal and professional fees	672,317	116,883	-	-	789,200
Interest expense	4,976,599	1,849,861	2,582,697	-	9,409,157
Other expenses	1,283,269	816,009	865,934	(840,935)	2,124,277
TOTAL EXPENSES	9,145,241	3,571,040	5,262,833	(2,655,137)	15,323,977
INCOME (LOSS) BEFORE EQUITY IN INCOME OF SUBSIDIARIES	(5,877,787)	(778,983)	10,848,388	-	4,191,618
EQUITY IN INCOME OF SUBSIDIARIES	10,069,405	10,896,907	10,848,388	(20,966,312)	-
INCOME BEFORE INCOME TAXES	4,191,618	10,117,924	10,848,388	(20,966,312)	4,191,618
INCOME TAX EXPENSE	2,367,794	-	-	-	2,367,794
NET INCOME	$1,823,824	$10,117,924	$ 10,848,388	$(20,966,312)	$1,823,824

For the six months ended June 30, 2012	Parent	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUE					
Contract servicing fees	$-	$438,250	$ -	$(438,250)	$ -
Gain on life settlements, net	-	229,277	5,239,969	-	5,469,246
Interest and other income	3,049	3,192	42,653	-	48,894
TOTAL REVENUE	3,049	670,719	5,282,622	(438,250)	5,518,140
EXPENSES					
Origination and servicing fees	-	(6,500)	444,750	(438,250)	-
	-	1,117,084	-	-	1,117,084

Employee compensation and benefits					
Legal and professional fees	655,600	45,803	-	-	701,403
Interest expense	1,268,211	2,696,548	853,232	-	4,817,991
Other expenses	534,100	703,552	25,000	-	1,262,652
TOTAL EXPENSES	2,457,911	4,556,487	1,322,982	(438,250)	7,899,130
INCOME (LOSS) BEFORE EQUITY IN INCOME OF SUBSIDIARIES	(2,454,862)	(3,885,768)	3,959,640	-	(2,380,990)
EQUITY IN INCOME OF SUBSIDIARIES	73,872	4,017,864	-	(4,091,736)	-
INCOME BEFORE INCOME TAXES	(2,380,990)	132,096	3,959,640	(4,091,736)	(2,380,990)
INCOME TAX BENEFIT	(529,860)	-	-	-	(529,860)
NET INCOME (LOSS)	$(1,851,130)	$132,096	$ 3,959,640	$(4,091,736)	$(1,851,130)

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Condensed Consolidating Statements of Operations (continued)

For the three months ended June 30, 2013	Parent	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUE					
Contract servicing fees	$ -	$ 536,100	$ -	$ (536,100)	$ -
Gain on life settlements, net	-	-	7,733,245	-	7,733,245
Interest and other income	3,259,362	841,286	14,610	(840,935)	3,274,323
TOTAL REVENUE	3,259,362	1,377,386	7,747,855	(1,377,035)	11,007,568
EXPENSES					
Origination and servicing fees	-	-	536,100	(536,100)	-
Employee compensation and benefits	666,354	397,569	-	-	1,063,923
Legal and professional fees	272,794	79,116	-	-	351,910
Interest expense	2,655,430	942,686	1,343,826	-	4,941,942
Other expenses	649,112	429,520	853,435	(840,935)	1,091,132
TOTAL EXPENSES	4,243,690	1,848,891	2,733,361	(1,377,035)	7,448,907
INCOME (LOSS) BEFORE EQUITY IN INCOME OF SUBSIDIARIES	(984,328)	(471,505)	5,014,494	-	3,558,661
EQUITY IN INCOME OF SUBSIDIARIES	4,543,289	5,014,494	-	(9,557,783)	-
INCOME BEFORE INCOME TAXES	3,558,961	4,542,989	5,014,494	(9,557,783)	3,558,661
INCOME TAX EXPENSE (BENEFIT)	1,802,271	(300)	-	-	1,801,971
NET INCOME	$ 1,756,690	$ 4,543,289	$ 5,014,494	$ (9,557,783)	$ 1,756,690

For the three months ended June 30, 2012	Parent	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUE					
Contract servicing fees	$ -	$ 290,050	$ -	$ (290,050)	$ -
Gain on life settlements, net	-	79,307	4,788,171	-	4,867,478
Interest and other income	2,745	2,237	42,581	-	47,563
TOTAL REVENUE	2,745	371,594	4,830,752	(290,050)	4,915,041
EXPENSES					
Origination and servicing fees	-	-	290,050	(290,050)	-
Employee compensation and benefits	-	583,338	-	-	583,338

Legal and professional fees	364,698	(27,519)	-	-	337,179
Interest expense	814,038	1,140,239	425,301	-	2,379,578
Other expenses	387,691	303,468	12,500	-	703,659
TOTAL EXPENSES	1,566,427	1,999,526	727,851	(290,050)	4,003,754
INCOME (LOSS) BEFORE EQUITY IN INCOME OF SUBSIDIARIES	(1,563,682)	(1,627,932)	4,102,901	-	911,287
EQUITY IN INCOME OF SUBSIDIARIES	2,474,969	4,132,013	-	(6,606,982)	-
INCOME BEFORE INCOME TAXES	911,287	2,504,081	4,102,901	(6,606,982)	911,287
INCOME TAX EXPENSE	609,588	-	-	-	609,588
NET INCOME	$ 301,699	$ 2,504,081	$ 4,102,901	$ (6,606,982)	$ 301,699

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Condensed Consolidating Statements of Cash Flows

For the six months ended June 30, 2013	Parent	Guarantor Sub	Non-Guarantor Sub	Eliminations	Consolidated
CASH FLOWS FROM OPERATING ACTIVITIES					
Net income	$ 1,823,824	$ 10,117,924	$ 10,848,388	$ (20,966,312)	$ 1,823,824
Adjustments to reconcile net income to cash:					
Equity income of subsidiaries	(982,826)	(867,920)	-	1,850,746	-
Gain on life settlements	-	-	(18,943,905)	-	(18,943,905)
Amortization of deferred financing and issuance costs	737,959	434,431	758,490	-	1,930,880
Deferred income taxes	2,366,794	-	-	-	2,366,794
Preferred stock issued for dividends	261,937	-	-	-	261,937
(Increase) decrease in operating assets:					
Other assets	(27,278,091)	(24,355,215)	(3,330,802)	51,349,976	(3,614,132)
Increase (decrease) in operating liabilities:					
Accounts payable and other accrued expenses	1,485,107	119,503	90,187	-	1,694,797
NET CASH FLOWS USED IN OPERATING ACTIVITIES	(21,585,296)	(14,551,277)	(10,577,642)	32,234,410	(14,479,805)
CASH FLOWS FROM INVESTING ACTIVITIES					
Investment in life settlements	-	-	(12,885,993)	-	(12,885,993)
Proceeds from settlement of life settlements	-	-	2,872,152	-	2,872,152
NET CASH FLOWS USED IN INVESTING ACTIVITIES	-	-	(10,013,841)	-	(10,013,841)
CASH FLOWS FROM FINANCING ACTIVITIES					
Net proceeds from revolving credit facility	-	-	8,000,000	-	8,000,000
Payments for redemption of Series I Secured notes payable	-	(3,930,876)	-	-	(3,930,876)
Proceeds from issuance of debentures	42,439,661	-	-	-	42,439,661
Payments from issuance and redemption of debentures	(5,336,571)	-	-	-	(5,336,571)
Payments from restricted cash	-	(752,800)	(1,617,975)	-	(2,370,775)
Issuance of member capital	-	18,024,952	14,209,458	(32,234,410)	-

Repurchase of common stock	(3,252,400)	-	-	-	(3,252,400)
Payments for redemption of preferred stock	(311,804)	-	-	-	(311,804)
NET CASH FLOWS PROVIDED BY FINANCING ACTIVITIES	33,538,886	13,341,276	20,591,483	(32,234,410)	35,237,235
NET INCREASE IN CASH AND CASH EQUIVALENTS	11,953,590	(1,210,001)	-	-	10,743,589
CASH AND CASH EQUIVALENTS					
BEGINNING OF THE PERIOD	25,035,579	2,461,465	-	-	27,497,044
END OF THE PERIOD	$ 36,989,169	$ 1,251,464	$ -	$ -	$ 38,240,633

GWG HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Consolidating Statements of Cash Flows (continued)

For the six months ended June 30, 2012	Parent	Guarantor Sub	Non-Guarantor Sub	Eliminations	Consolidated
CASH FLOWS FROM OPERATING ACTIVITIES					
Net income	$ (1,851,130)	$ 132,096	$ 3,949,640	$ (4,091,736)	$ (1,851,130)
Adjustments to reconcile net income to cash:					
Equity income of subsidiaries	(8,985,743)	(238,602)	5,132,609	4,091,736	-
(Gain) loss on life settlements	-	999,677	(11,989,926)	-	(10,990,249)
Amortization of deferred financing and issuance costs	46,622	746,387	116,448	-	909,457
Deferred income taxes	(529,860)	-	-	-	(529,860)
Preferred stock issued for dividends	421,010	-	-	-	421,010
(Increase) decrease in operating assets:					
Other assets	(13,027)	1,217,186	(146,874)	-	1,057,285
Increase (decrease) in operating liabilities:					
Accounts payable and other accrued expenses	606,991	39,087	13,056	-	659,134
NET CASH FLOWS USED IN OPERATING ACTIVITIES	(10,305,137)	2,895,831	(2,915,047)	-	(10,324,353)
CASH FLOWS FROM INVESTING ACTIVITIES					
Investment in life settlements	-	-	(2,622,030)	-	(2,622,030)
Proceeds from settlement of life settlements	-	-	416,665	-	416,665
NET CASH FLOWS USED IN INVESTING ACTIVITIES	-	-	(2,205,365)	-	(2,205,365)
CASH FLOWS FROM FINANCING ACTIVITIES					