

GWG Holdings, Inc.
Form 10-Q
May 11, 2018
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2018

or

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

For the transition period from _____ to _____

Commission File Number: None

GWG HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

26-2222607

(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)

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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. x 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | |
|-------------------------|---|---------------------------|---|
| Large accelerated filer | " | Accelerated filer | " |
| Non-accelerated filer | " (Do not check if a smaller reporting company) | Smaller reporting company | x |
| | | Emerging growth company | x |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. "

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

As of May 11, 2018, GWG Holdings, Inc. had 5,813,555 shares of common stock outstanding.

GWG HOLDINGS, INC.

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for the Quarter Ended March 31, 2018

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GWG HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

| | March 31, 2018 (unaudited) | December 31, 2017 |
|--|----------------------------------|-----------------------|
| <u>ASSETS</u> | | |
| Cash and cash equivalents | \$ 141,212,907 | \$ 114,421,491 |
| Restricted cash | 16,552,256 | 28,349,685 |
| Investment in life insurance policies, at fair value | 687,389,479 | 650,527,353 |
| Secured MCA advances | 1,639,818 | 1,661,774 |
| Life insurance policy benefits receivable | 12,302,730 | 16,658,761 |
| Other assets | 7,402,317 | 7,237,110 |
| TOTAL ASSETS | \$ 866,499,507 | \$ 818,856,174 |
| <u>LIABILITIES & STOCKHOLDERS' EQUITY</u> | | |
| LIABILITIES | | |
| Senior credit facility with LNV Corporation | \$ 209,447,613 | \$ 212,238,192 |
| L Bonds | 469,729,977 | 447,393,568 |
| Accounts payable | 3,611,900 | 6,394,439 |
| Interest and dividends payable | 15,896,267 | 15,427,509 |
| Other accrued expenses | 4,066,763 | 3,730,723 |
| TOTAL LIABILITIES | \$ 702,752,520 | \$ 685,184,431 |
| STOCKHOLDERS' EQUITY | | |
| REDEEMABLE PREFERRED STOCK | | |
| (par value \$0.001; shares authorized 100,000; shares outstanding 98,358 and 98,611; liquidation preference of \$98,932,000 and \$99,186,000 as of March 31, 2018 and December 31, 2017, respectively) | 90,915,026 | 92,840,243 |
| SERIES 2 REDEEMABLE PREFERRED STOCK | | |
| (par value \$0.001; shares authorized 150,000; shares outstanding 134,951 and 88,709; liquidation preference of \$135,712,000 and \$89,208,000 as of March 31, 2018 and December 31, 2017, respectively) | 121,454,205 | 80,275,204 |
| COMMON STOCK | | |
| (par value \$0.001; shares authorized 210,000,000; shares issued and outstanding 5,813,555 as of both March 31, 2018 and December 31, 2017) | 5,813 | 5,813 |
| Additional paid-in capital | — | — |
| Accumulated deficit | (48,628,057) | (39,449,517) |
| TOTAL STOCKHOLDERS' EQUITY | 163,746,987 | 133,671,743 |
| TOTAL LIABILITIES & STOCKHOLDERS' EQUITY | \$ 866,499,507 | \$ 818,856,174 |

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 March 31, 2018 | March 31, 2017 |
|--|---|-------------------|
| REVENUE | | |
| Gain on life insurance policies, net | \$ 13,868,745 | \$ 19,399,819 |
| MCA income | 66,810 | 246,577 |
| Interest and other income | 606,117 | 441,949 |
| TOTAL REVENUE | 14,541,672 | 20,088,345 |
| EXPENSES | | |
| Interest expense | 16,063,337 | 13,244,215 |
| Employee compensation and benefits | 3,742,669 | 3,163,062 |
| Legal and professional fees | 1,173,629 | 946,348 |
| Other expenses | 2,740,577 | 2,780,322 |
| TOTAL EXPENSES | 23,720,212 | 20,133,947 |
| INCOME (LOSS) BEFORE INCOME TAXES | (9,178,540) | (45,602) |
| INCOME TAX EXPENSE (BENEFIT) | — | (500) |
| NET INCOME (LOSS) | (9,178,540) | (45,102) |
| Preferred stock dividends | 3,704,484 | 1,867,760 |
| NET INCOME (LOSS) ATTRIBUTABLE TO COMMON SHAREHOLDERS | \$ (12,883,024) | \$ (1,912,862) |
| NET INCOME (LOSS) PER SHARE | | |
| Basic | \$ (2.22) | \$ (0.32) |
| Diluted | \$ (2.22) | \$ (0.32) |
| WEIGHTED AVERAGE SHARES OUTSTANDING | | |
| Basic | 5,813,555 | 5,912,946 |
| Diluted | 5,813,555 | 5,912,946 |

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

GWG HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

| | Three Months Ended March 31, 2018 | March 31, 2017 |
|---|---|----------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income (loss) | \$ (9,178,540) | \$ (45,102) |
| Adjustments to reconcile net income (loss) to net cash flows from operating activities: | | |
| Change in fair value of life insurance policies | (16,645,594) | (13,883,833) |
| Amortization of deferred financing and issuance costs | 2,263,188 | 2,666,203 |
| Deferred income taxes | — | (500) |
| Preferred stock issued in lieu of cash dividends | — | 336,789 |
| (Increase) decrease in operating assets: | | |
| Life insurance policy benefits receivable | 4,356,031 | (3,630,000) |
| Other assets | (165,207) | 1,426,318 |
| Increase (decrease) in operating liabilities: | | |
| Accounts payable and other accrued expenses | (1,545,208) | 1,209,417 |
| NET CASH FLOWS USED IN OPERATING ACTIVITIES | (20,915,330) | (11,920,708) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Investment in life insurance policies | (25,299,825) | (22,689,333) |
| Carrying value of matured life insurance policies | 5,083,294 | 2,368,974 |
| Proceeds from Secured MCA advances | 88,766 | 770,387 |
| NET CASH FLOWS USED IN INVESTING ACTIVITIES | (20,127,765) | (19,549,972) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net borrowings on (repayments of) Senior Credit Facilities | (3,054,335) | (3,254,500) |
| Payments for issuance of senior debt | — | (114,294) |
| Payments for redemption of Series I Secured Notes | — | (5,449,889) |
| Proceeds from issuance of L Bonds | 36,661,099 | 24,868,659 |
| Payments for issuance and redemption of L Bonds | (12,245,448) | (24,171,597) |
| Repurchase of common stock | — | (1,603,560) |
| Proceeds from issuance of preferred stock | 41,865,169 | 27,179,194 |
| Payment for issuance of preferred stock | (3,157,695) | (2,017,487) |
| Payment for redemption of preferred stock | (327,224) | (386,739) |
| Preferred stock dividends | (3,704,484) | (1,867,760) |
| NET CASH FLOWS PROVIDED BY FINANCING ACTIVITIES | 56,037,082 | 13,182,027 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 14,993,987 | (18,288,653) |
| CASH AND CASH EQUIVALENTS AND RESTRICTED CASH | | |
| BEGINNING OF PERIOD | 142,771,176 | 116,313,578 |
| END OF PERIOD | \$ 157,765,163 | \$ 98,024,925 |

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

GWG HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS — CONTINUED

(unaudited)

| | Three Months Ended March 31, 2018 | March 31, 2017 |
|---|---|-------------------|
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | |
| Interest paid | \$ 13,475,000 | \$ 10,471,000 |
| Premiums paid, including prepaid | \$ 11,833,000 | \$ 10,960,000 |
| Stock-based compensation | \$ 213,000 | \$ 303,000 |
| Payments for exercised stock options | \$ 37,000 | \$ — |
| NON-CASH INVESTING AND FINANCING ACTIVITIES | | |
| L Bonds: | | |
| Conversion of accrued interest and commissions payable to principal | \$ 342,000 | \$ 508,000 |
| Conversion of maturing L Bonds to redeemable preferred stock | \$ 4,421,000 | \$ — |
| Series A Preferred Stock: | | |
| Issuance of Series A Preferred Stock in lieu of cash dividends | \$ — | \$ 171,000 |
| Investment in life insurance policies included in accounts payable | \$ 1,350,000 | \$ 1,237,000 |

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

GWG HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(unaudited)

| | Preferred Stock Shares | Preferred Stock | Common Shares | Common Stock (par) | Additional Paid-in Capital | Accumulated Deficit | Total Equity |
|--|------------------------------|-----------------------|------------------|--------------------------|----------------------------------|------------------------|-----------------------|
| Balance, December 31, 2016 | 2,699,704 | \$ 78,726,297 | 5,980,190 | \$ 5,980 | \$ 7,383,515 | \$ (18,817,294) | \$ 67,298,498 |
| Net loss | — | — | — | — | — | (20,632,223) | (20,632,223) |
| Issuance of common stock | — | — | 33,810 | 33 | 320,970 | — | 321,003 |
| Redemption of common stock | — | — | (200,445) | (200) | (1,603,360) | — | (1,603,560) |
| Issuance of Series A preferred stock | 71,237 | 498,659 | — | — | — | — | 498,659 |
| Redemption of Series A preferred stock | (2,711,916) | (20,199,792) | — | — | — | — | (20,199,792) |
| Issuance of redeemable preferred stock | 129,622 | 122,933,106 | — | — | (2,338,457) | — | 120,594,649 |
| Redemption of redeemable preferred stock | (1,328) | (1,327,776) | — | — | — | — | (1,327,776) |
| Preferred stock dividends | — | (8,925,807) | — | — | (3,776,534) | — | (12,702,341) |
| Stock-based compensation | — | 1,410,760 | — | — | 13,866 | — | 1,424,626 |
| Balance, December 31, 2017 | 187,319 | \$ 173,115,447 | 5,813,555 | \$ 5,813 | \$ — | \$ (39,449,517) | \$ 133,671,743 |
| Net income | — | — | — | — | — | (9,178,540) | (9,178,540) |
| Issuance of redeemable | 46,317 | 43,159,571 | — | — | — | — | 43,159,571 |

preferred stock

Redemption of
redeemable

| | | | | | | | |
|-----------------|--------|------------|---|---|---|---|------------|
| preferred stock | (327) | (327,224) | — | — | — | — | (327,224) |
|-----------------|--------|------------|---|---|---|---|------------|

Preferred stock
dividends

| | | | | | | |
|---|--------------|---|---|---|---|--------------|
| — | (3,704,484) | — | — | — | — | (3,704,484) |
|---|--------------|---|---|---|---|--------------|

Stock-based
compensation

| | | | | | | |
|---|---------|---|---|---|---|---------|
| — | 125,921 | — | — | — | — | 125,921 |
|---|---------|---|---|---|---|---------|

**Balance,
March 31,
2018**

| | | | | | | |
|----------------|-----------------------|------------------|-----------------|-------------|------------------------|-----------------------|
| 233,309 | \$ 212,369,231 | 5,813,555 | \$ 5,813 | \$ — | \$ (48,628,057) | \$ 163,746,987 |
|----------------|-----------------------|------------------|-----------------|-------------|------------------------|-----------------------|

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 — We are a financial services company committed to disrupting and transforming the life insurance and related industries. We built our business by creating opportunities for consumers to obtain significantly more value for their life insurance policies in a secondary market as compared to the traditional options offered by the insurance industry. We are enhancing and extending our activities in the life insurance industry through innovation in our products and services, business processes, financing strategies, and advanced epigenetic technologies. At the same time, we are creating opportunities for investors to receive income and capital appreciation from our investment activities in the life insurance and related industries.

GWG Holdings, Inc. and all of its subsidiaries are incorporated and organized in Delaware. Unless the context otherwise requires or we specifically so indicate, all references in these footnotes to “we,” “us,” “our,” “our Company,” “GWG” or the “Company” refer to GWG Holdings, Inc. and its subsidiaries collectively and on a consolidated basis. References to the full names of particular entities, such as “GWG Holdings, Inc.” or “GWG Holdings,” are meant to refer only to the particular entity referenced.

On December 7, 2015, GWG Holdings formed a wholly owned subsidiary, GWG MCA, LLC. On January 13, 2016, GWG MCA, LLC was converted to a corporation and became GWG MCA Capital, Inc. GWG MCA Capital, Inc. was formed to provide cash advances to small businesses.

On August 25, 2016, GWG Holdings formed a wholly owned subsidiary, Actüa Life & Annuity Ltd., renamed to Life Epigenetics Inc. (“Life Epigenetics”) in August 2017, to engage in various life insurance related businesses and activities related to its exclusive license for “DNA Methylation Based Predictor of Mortality” technology.

Use of Estimates — The preparation of our condensed consolidated financial statements in conformity with the Generally Accepted Accounting Principles in the United States of America (GAAP) requires management to make significant estimates and assumptions affecting the reported amounts of assets and liabilities at the date of the condensed consolidated financial statements, as well as the reported amounts of revenue during the reporting period. We regularly evaluate estimates and assumptions, which are based on current facts, historical experience, management’s judgment, and various other factors that we believe to be reasonable under the circumstances. Our actual results may differ materially and adversely from our estimates. The most significant estimates with regard to these condensed consolidated financial statements relate to (1) the determination of the assumptions used in estimating the fair value of our investments in life insurance policies and (2) the value of our deferred tax assets and liabilities.

Cash and Cash Equivalents — We consider cash in demand deposit accounts and temporary investments purchased with an original maturity of three months or less to be cash equivalents. We maintain our cash and cash equivalents with highly rated financial institutions. The balances in our bank accounts may exceed Federal Deposit Insurance Corporation limits. We periodically evaluate the risk of exceeding insured levels and may transfer funds as we deem appropriate.

Life Insurance Policies — Accounting Standards Codification 325-30, Investments in Insurance Contracts permits a reporting entity to account for its investments in life insurance policies using either the investment method or the fair value method. We elected to use the fair value method to account for our life insurance policies. We initially record our purchase of life insurance policies at the transaction price, which is the amount paid for the policy, inclusive of all external fees and costs associated with the acquisition. At each subsequent reporting period, we re-measure the

investment at fair value in its entirety and recognize the change in fair value as unrealized gain or loss in the current period, net of premiums paid, within gain on life insurance policies, net in our condensed consolidated statements of operations.

In a case where our acquisition of a policy is not complete as of a reporting date, but we have nonetheless advanced direct costs and deposits for the acquisition, those costs and deposits are recorded as other assets on our condensed consolidated balance sheets until the acquisition is complete and we have secured title to the policy. On both March 31, 2018 and December 31, 2017, a total of \$0 of our other assets comprised direct costs and deposits that we had advanced for life insurance policy acquisitions.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(1) Nature of Business and Summary of Significant Accounting Policies (cont.)

We also recognize realized gain (or loss) from a life insurance policy upon one of the two following events: (1) our receipt of notice or verified mortality of the insured; or (2) our sale of the policy (upon filing of change-of-ownership forms and receipt of payment). In the case of mortality, the gain (or loss) we recognize is the difference between the policy benefits and the carrying value of the policy once we determine that collection of the policy benefits is realizable and reasonably assured. In the case of a policy sale, the gain (or loss) we recognize is the difference between the sale price and the carrying value of the policy on the date we receive sale proceeds.

Other Assets — Life Epigenetics is engaged in various life insurance related businesses and activities related to its exclusive license for the “DNA Methylation Based Predictor of Mortality” technology for the life insurance industry. The cost of entering into this license agreement is included in other assets on our condensed consolidated balance sheets.

To maintain the Company’s life insurance provider licenses in certain states, we are required to keep cash security deposits with the states’ licensing authorities. Security deposits included in other assets were \$575,000 at both March 31, 2018 and December 31, 2017.

Stock-Based Compensation — We measure and recognize compensation expense for all stock-based payments at fair value on the grant date over the requisite service period. We use the Black-Scholes option pricing model to determine the weighted-average fair value of options. For restricted stock grants, fair value is determined as of the closing price of our common stock on the date of grant. Stock-based compensation expense is recorded in general and administrative expenses based on the classification of the employee or vendor. The determination of fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as by assumptions regarding a number of subjective variables. These variables include, but are not limited to, the expected stock price volatility over the term of the awards and the expected duration.

The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected life at grant date. Volatility is based on the standard deviation of the average continuously compounded rate of return of five selected comparable companies. We have not historically issued any common stock dividends and do not expect to do so in the foreseeable future.

Deferred Financing and Issuance Costs — Loans advanced to us under our senior credit facility with LNV Corporation, as described in Note 6, are reported net of financing costs, including issuance costs, sales commissions and other direct expenses, which are amortized using the straight-line method over the term of the facility. We had no loans advanced to us under our senior credit facility with Autobahn Funding Company during the year ended December 31, 2017, as described in Note 5. The Series I Secured Notes and L Bonds, as respectively described in Notes 7 and 8, are reported net of financing costs, which are amortized using the interest method over the term of those borrowings. The Series A Convertible Preferred Stock (“Series A”), as described in Note 9, was reported net of financing costs (including the fair value of warrants issued), all of which were fully amortized using the interest method as of December 31, 2017. Selling and issuance costs of Redeemable Preferred Stock (“RPS”) and Series 2 Redeemable Preferred Stock (“RPS 2”), described in Notes 10 and 11, are netted against additional paid-in-capital, if any, and then against the outstanding balance of the preferred stock.

Earnings (loss) per Share — Basic earnings (loss) per share attributable to common shareholders are calculated using the weighted-average number of shares outstanding during the reported period. Diluted earnings (loss) per share are calculated based on the potential dilutive impact of our Series A, RPS, RPS 2, warrants and stock options. Due to our net loss attributable to common shareholders for the three months ended March 31, 2018, there are no dilutive securities.

Recently Issued Accounting Pronouncements — On February 25, 2016, the FASB issued Accounting Standards Update 2016-02 Leases (“ASU 2016-02”). The new guidance is effective for fiscal years beginning after December 15, 2018. ASU 2016-02 provides more transparency and comparability in the financial statements of lessees by recognizing all leases with a term greater than twelve months on the balance sheet. Lessees will also be required to disclose key information about their leases. Early adoption is permitted. We are currently evaluating the impact of the adoption of this pronouncement and have not yet adopted ASU 2016-02 as of March 31, 2018.

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(1) Nature of Business and Summary of Significant Accounting Policies (cont.)

In March 2016, the FASB issued Accounting Standards Update 2016-09 (“ASU 2016-09”) to simplify the accounting for stock compensation related to the following items: income tax accounting, award classification, estimation of forfeitures, and cash flow presentation. The new guidance is effective for fiscal years beginning after December 15, 2016. We adopted ASU 2016-09 effective January 1, 2017. The impact of the adoption was not material to the financial statements.

In November 2016, the FASB issued Accounting Standards Update 2016-18 (“ASU 2016-18”), which amends ASC 230 Statement of Cash Flows to add or clarify guidance on the classification and presentation of restricted cash in the statement of cash flows. The guidance, to be applied retrospectively when adopted, requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. The new guidance is effective for fiscal years beginning after December 15, 2017, and interim periods within those years. We adopted ASU 2016-18 as of March 31, 2018. The impact of the adoption was not material to the financial statements.

(2) Restrictions on Cash

Under the terms of our senior credit facility with LNV Corporation (discussed in Note 6), we are required to maintain collection and payment accounts that are used to collect policy benefits from pledged policies, pay annual policy premiums, interest and other charges under the facility, and distribute funds to pay down the facility. The agents for the lender authorize the disbursements from these accounts. At March 31, 2018 and December 31, 2017, there was a balance of \$11,735,000 and \$19,967,000, respectively, in these collection and payment accounts.

To fund the Company’s acquisition of life insurance policies, we are required to maintain escrow accounts. Distributions from these accounts are made according to life insurance policy purchase contracts. At March 31, 2018 and December 31, 2017, there was a balance of \$4,818,000 and \$8,383,000, respectively, in the Company’s escrow accounts.

(3) Investment in Life Insurance Policies

Life insurance policies are valued based on unobservable inputs that are significant to their overall fair value. Changes in the fair value of these policies, net of premiums paid, are recorded in gain on life insurance policies, net in our condensed consolidated statements of operations. Fair value is determined on a discounted cash flow basis that incorporates life expectancy assumptions generally derived from reports obtained from widely accepted life expectancy providers, other than insured lives covered under small face amount policies (i.e., \$1 million in face value benefits or less), assumptions relating to cost-of-insurance (premium) rates and other assumptions. The discount rate we apply incorporates current information about discount rates applied by other public reporting companies owning portfolios of life insurance policies, the discount rates observed in the life insurance secondary market, market interest rates, the estimated credit exposure to the insurance companies that issued the life insurance policies and management’s estimate of the operational risk premium a purchaser would require to receive the future cash flows derived from our portfolio as a whole. Management has discretion regarding the combination of these and other factors when determining the discount rate. As a result of management’s analysis, a discount rate of 10.45% was applied to our portfolio as of both March 31, 2018 and December 31, 2017.

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(3) Investment in Life Insurance Policies (cont.)

A summary of our policies, organized according to their estimated life expectancy dates as of the reporting date, is as follows:

| | As of March 31, 2018 | | | As of December 31, 2017 | | |
|------------------------------------|--------------------------|-------------------------|---------------|--------------------------|-------------------------|------------------|
| Years Ending December 31, | Number of Policies | Estimated Fair Value | Face Value | Number of Policies | Estimated Fair Value | Face Value |
| 2018 | 7 | \$ 4,584,000 | \$ 4,889,000 | 8 | \$ 4,398,000 | \$ 4,689,000 |
| 2019 | 39 | 48,373,000 | 62,030,000 | 48 | 63,356,000 | 83,720,000 |
| 2020 | 82 | 82,265,000 | 129,005,000 | 87 | 79,342,000 | 127,373,000 |
| 2021 | 95 | 95,308,000 | 164,094,000 | 98 | 96,154,000 | 170,695,000 |
| 2022 | 113 | 102,343,000 | 202,210,000 | 90 | 85,877,000 | 181,120,000 |
| 2023 | 93 | 74,048,000 | 181,905,000 | 93 | 69,467,000 | 175,458,000 |
| 2024 | 103 | 78,156,000 | 225,134,000 | 100 | 77,638,000 | 228,188,000 |
| Thereafter | 410 | 202,312,000 | 788,799,000 | 374 | 174,295,000 | 704,905,000 |
| Totals | 942 | 687,389,000 | 1,758,066,000 | 898 | \$ 650,527,000 | \$ 1,676,148,000 |

We recognized life insurance benefits of \$14,504,000 and \$18,975,000 during the three months ended March 31, 2018 and 2017, respectively, related to policies with a carrying value of \$5,083,000 and \$2,369,000, respectively, and as a result recorded realized gains of \$9,421,000 and \$16,606,000.

Reconciliation of gain on life insurance policies:

| | March 31, 2018 | March 31, 2017 |
|--|-------------------|-------------------|
| Change in estimated probabilistic cash flows | \$ 19,005,000 | \$ 14,034,000 |
| Unrealized gain on acquisitions | 6,974,000 | 10,602,000 |
| Premiums and other annual fees | (12,197,000) | (11,090,000) |
| Change in discount rates(1) | — | — |
| Change in life expectancy evaluation(2) | (4,868,000) | (1,942,000) |
| Face value of matured policies | 14,504,000 | 18,975,000 |
| Fair value of matured policies | (9,549,000) | (11,179,000) |
| Gain on life insurance policies, net | \$ 13,869,000 | \$ 19,400,000 |

(1) The discount rate applied to estimate the fair value of the portfolio of life insurance policies we own was 10.45% as of March 31, 2018 and 10.96% as of March 31, 2017. The carrying value of policies acquired during each quarterly reporting period is adjusted to current fair value using the fair value discount rate applied to the entire portfolio as of that reporting date.

(2) The change in fair value due to updating life expectancy estimates on certain life insurance policies in our portfolio.

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We currently estimate that premium payments and servicing fees required to maintain our current portfolio of life insurance policies in force for the next five years, assuming no mortalities, are as follows:

| Years Ending December 31, | Premiums | Servicing | Premiums and Servicing Fees |
|--------------------------------------|----------------|-----------|-----------------------------|
| Nine months ending December 31, 2018 | \$ 41,177,000 | 995,000 | 42,172,000 |
| 2019 | 61,480,000 | 1,327,000 | 62,807,000 |
| 2020 | 70,661,000 | 1,327,000 | 71,988,000 |
| 2021 | 80,949,000 | 1,327,000 | 82,276,000 |
| 2022 | 92,191,000 | 1,327,000 | 93,518,000 |
| 2023 | 102,177,000 | 1,327,000 | 103,504,000 |
| | \$ 448,635,000 | 7,630,000 | 456,265,000 |

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GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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(3) Investment in Life Insurance Policies (cont.)

Management anticipates funding the majority of the premium payments estimated above with additional borrowing capacity, created as the premiums and servicing costs of pledged life insurance policies become due, under the amended and restated senior credit facility with LNV Corporation as described in Note 6 and the net proceeds from our offering of L Bonds as described in Note 8. Management anticipates funding premiums and servicing costs of non-pledged life insurance policies with proceeds from the receipt of policy benefits from our portfolio of life insurance policies and net proceeds from our offering of L Bonds. The proceeds of these capital sources may also be used for the purchase, policy premiums and servicing costs of additional life insurance policies as well as for other working capital and financing expenditures including paying principal, interest and dividends.

(4) Fair Value Definition and Hierarchy

Accounting Standards Codification 820, Fair Value Measurements and Disclosures (“ASC 820”) establishes a hierarchical disclosure framework that 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 and actively 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 maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring the use of observable inputs whenever available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from independent sources. Unobservable inputs are inputs that reflect assumptions about how market participants price an asset or liability based on the best available information. 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. Because 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.

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 our portfolio of life insurance policies is determined on a quarterly basis by management taking into consideration changes in discount rate assumptions, estimated premium payments and life expectancy estimate assumptions, as well as any changes in economic and other relevant conditions. The discount rate incorporates current information about discount rates applied by other reporting companies owning portfolios of life insurance policies, the discount rates observed in the life insurance secondary market, market interest rates, the estimated credit

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GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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(4) Fair Value Definition and Hierarchy (cont.)

exposure to the insurance company that issued the life insurance policy and management's estimate of the operational risk premium a purchaser would require to receive the future cash flows derived from our portfolio as a whole. Management has discretion regarding the combination of these and other factors when determining the discount rate.

These inputs are then used to estimate the discounted cash flows from the portfolio using the Model Actuarial Pricing System ("MAPS") probabilistic and stochastic portfolio pricing model, which estimates the expected cash flows using various mortality probabilities and scenarios. The valuation process includes a review by senior management as of each valuation date. We also engage MAPS to independently test the accuracy of the valuations using the inputs we provide on a quarterly basis. A copy of a letter documenting the MAPS calculation is filed as Exhibit 99.1 to this report.

The following table reconciles the beginning and ending fair value of our Level 3 investments in our portfolio of life insurance policies for the periods ended March 31, as follows:

| | Three Months Ended | |
|---------------------------------|--------------------|-------------------|
| | March 31, 2018 | March 31, 2017 |
| Beginning balance | \$ 650,527,000 | \$ 511,192,000 |
| Purchases | 25,300,000 | 22,690,000 |
| Maturities (initial cost basis) | (5,083,000) | (2,369,000) |
| Net change in fair value | 16,645,000 | 13,884,000 |
| Ending balance | \$ 687,389,000 | \$ 545,397,000 |

In the past, we periodically updated the life expectancy estimates on the insured lives in our portfolio, other than insured lives covered under small face amount policies (i.e., \$1 million in face value benefits or less), on a continuous rotating three-year cycle, and through that effort attempted to update life expectancies for approximately one-twelfth of our portfolio each quarter. Currently, however, the terms of our senior credit facility with LNV Corporation require us to update the life expectancy estimates every two years, on policies pledged to them, beginning from the date of the amended facility.

The following table summarizes the inputs utilized in estimating the fair value of our portfolio of life insurance policies:

| | As of March 31, 2018 | As of December 31, 2017 |
|---|----------------------------|-------------------------------|
| Weighted-average age of insured, years* | 81.9 | 81.7 |
| Weighted-average life expectancy, months* | 82.3 | 82.4 |
| Average face amount per policy | \$ 1,866,000 | \$ 1,867,000 |
| Discount rate | 10.45 % | 10.45 % |

(*) Weighted-average by face amount of policy benefits

GWG HOLDINGS, INC. AND SUBSIDIARIES

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(4) Fair Value Definition and Hierarchy (cont.)

Life expectancy estimates and market discount rates for a portfolio of life insurance policies are inherently uncertain and the effect of changes in estimates may be significant. For example, if the life expectancy estimates were increased or decreased by four and eight months on each outstanding policy, and the discount rates were increased or decreased by 1% and 2%, with all other variables held constant, the fair value of our investment in life insurance policies would increase or decrease as summarized below:

Change in Fair Value of the Investment in Life Insurance Policies

| | Change in life expectancy estimates | | | |
|-------------------|-------------------------------------|----------------|------------------|------------------|
| | minus 8 months | minus 4 months | plus 4 months | plus 8 months |
| March 31, 2018 | \$ 91,196,000 | \$ 45,252,000 | \$ (44,850,000) | \$ (88,987,000) |
| December 31, 2017 | \$ 86,391,000 | \$ 42,886,000 | \$ (42,481,000) | \$ (84,238,000) |

| | Change in discount rate | | | |
|-------------------|-------------------------|---------------|------------------|------------------|
| | minus 2% | minus 1% | plus 1% | plus 2% |
| March 31, 2018 | \$ 71,950,000 | \$ 34,419,000 | \$ (31,645,000) | \$ (60,809,000) |
| December 31, 2017 | \$ 68,117,000 | \$ 32,587,000 | \$ (29,964,000) | \$ (57,583,000) |

Other Fair Value Considerations

The carrying value of receivables, prepaid expenses, accounts payable and accrued expenses approximate fair value due to their short-term maturities and low credit risk. Using the income-based valuation approach, the estimated fair value of our L Bonds, having an aggregate face value of \$483,782,000 as of March 31, 2018, is approximately \$491,724,000 based on a weighted-average market interest rate of 6.74%. The carrying value of the senior credit facility with LNV Corporation reflects interest charged at 12-month LIBOR 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 facility approximates fair value.

GWG MCA participates in the merchant cash advance industry by directly advancing sums to merchants and lending money, on a secured basis, to companies that advance sums to merchants. Each quarter, we review the carrying value of these cash advances, and determine if an impairment reserve is necessary. At March 31, 2018 one of our secured cash advances was impaired. Specifically, the secured loan to Nulook Capital LLC had an outstanding balance of \$1,938,000 and a loan loss reserve of \$1,908,000 at March 31, 2018. We deem fair value to be the estimated collectible value on each loan or advance made from GWG MCA. Where we estimate the collectible amount to be less than the outstanding balance, we record a reserve for the difference, referred to as an impairment charge. We did not record an impairment charge in the three months periods ended March 31, 2018 or March 31, 2017.

The following table summarizes outstanding warrants (discussed in Note 13) as of March 31, 2018:

| Month issued | Warrants | | Fair value per share | Risk free rate | Volatility | Term | |
|----------------|----------|---------|----------------------|----------------|------------|------|---------|
| | issued | | | | | | |
| September 2014 | 16,000 | \$ 1.26 | 1.85 | % | 17.03 | % | 5 years |
| | 16,000 | | | | | | |

(5) Credit Facility — Autobahn Funding Company LLC

On September 12, 2017, we terminated our \$105 million senior credit facility with Autobahn Funding Company LLC, the Credit and Security Agreement governing the facility as well as the related pledge agreement, pursuant to which our obligations under the facility were secured. We paid off in full all obligations under the facility on September 14, 2016, and since that date, we have had no amounts outstanding under the facility.

The Credit and Security Agreement contained certain financial and non-financial covenants, and we were in compliance with these covenants during the year ended December 31, 2017 until the date of termination.

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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(6) Credit Facility — LNV Corporation

On September 27, 2017, we entered into an amended and restated senior credit facility with LNV Corporation as lender through our subsidiary GWG DLP Funding IV, LLC (“DLP IV”). The Amended and Restated Loan Agreement governing the facility makes available a total of up to \$300,000,000 in credit with a maturity date of September 27, 2029. Additional advances are available under the Amended and Restated Loan Agreement at the LIBOR rate as defined in the Amended and Restated Loan Agreement. Advances are available as the result of additional borrowing base capacity, created as the premiums and servicing costs of pledged life insurance policies become due. Interest will accrue on amounts borrowed under the Amended and Restated Loan Agreement at an annual interest rate, determined as of each date of borrowing or quarterly if there is no borrowing, equal to (A) the greater of 12-month LIBOR or the federal funds rate (as defined in the agreement) plus one-half of one percent per annum, plus (B) 7.50% per annum. The effective rate at March 31, 2018 was 9.63%. Interest payments are made on a quarterly basis.

As of March 31, 2018, approximately 78.1% of the total face value of our portfolio is pledged to LNV Corporation. The amount outstanding under this facility was \$219,470,000 and \$222,525,000 at March 31, 2018 and December 31, 2017, respectively. Obligations under the facility are secured by a security interest in DLP IV’s assets, for the benefit of the lenders under the Amended and Restated Loan Agreement, through an arrangement under which Wells Fargo serves as securities intermediary. The life insurance policies owned by DLP IV do not serve as direct collateral for the obligations of GWG Holdings under the L Bonds. The difference between the amount outstanding and the carrying amount on our condensed consolidated balance sheets is due to netting of unamortized debt issuance costs.

The Amended and Restated Loan Agreement has certain financial and nonfinancial covenants, and we were in compliance with these covenants at March 31, 2018 and December 31, 2017.

(7) Series I Secured Notes

Series I Secured Notes were legal obligations of GWG Life and were privately offered and sold from August 2009 through June 2011. On September 8, 2017, we redeemed all outstanding Series I Secured Notes for an aggregate of \$6,815,000.

(8) L Bonds

Our L Bonds are legal obligations of GWG Holdings. Obligations under the L Bonds are secured by the assets of GWG Holdings and by GWG Life, as a guarantor, and are subordinate to the obligations under our senior credit facility (see Note 6). We began publicly offering and selling L Bonds in January 2012 under the name “Renewable Secured Debentures”. These debt securities were re-named “L Bonds” in January 2015. L Bonds are publicly offered and sold on a continuous basis under a registration statement permitting us to sell up to \$1.0 billion in principal amount of L Bonds. On December 1, 2017, an additional public offering was declared effective permitting us to sell up to \$1.0 billion in principal amount of L Bonds on a continuous basis. The new offering is a follow-on to the previous L Bond offering and contains the same terms and features. We are party to an indenture governing the L Bonds dated October 19, 2011, as amended (“Indenture”), under which GWG Holdings is obligor, GWG Life is guarantor, and Bank of Utah serves as indenture trustee. The Indenture contains certain financial and non-financial covenants, and we were in compliance with these covenants at March 31, 2018 and December 31, 2017.

The bonds have renewal features under which we may elect to permit their renewal, subject to the right of bondholders to elect to receive payment at maturity. Interest is payable monthly or annually depending on the election of the investor.

At March 31, 2018 and December 31, 2017, the weighted-average interest rate of our L Bonds was 7.24% and 7.29%, respectively. The principal amount of L Bonds outstanding was \$483,782,000 and \$461,427,000 at March 31, 2018 and December 31, 2017, respectively. The difference between the amount of outstanding L Bonds and the carrying amount on our condensed consolidated balance sheets is due to netting of unamortized deferred issuance costs, cash receipts for new issuances and payments of redemptions in process. Amortization of deferred issuance costs were \$1,999,000 and \$1,929,000 for the three months ended March 31, 2018 and 2017, respectively. Future expected amortization of deferred financing costs as of March 31, 2018 is \$16,214,000 in total over the next seven years.

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(8) L Bonds (cont.)

Future contractual maturities of L Bonds, and future amortization of their deferred financing costs, at March 31, 2018 are as follows:

| Years Ending December 31, | Contractual Maturities | Amortization of Deferred Financing Costs |
|--------------------------------------|------------------------|--|
| Nine months ending December 31, 2018 | \$ 80,988,000 | \$ 699,000 |
| 2019 | 151,102,000 | 3,753,000 |
| 2020 | 93,940,000 | 3,605,000 |
| 2021 | 44,460,000 | 1,934,000 |
| 2022 | 39,938,000 | 2,015,000 |
| 2023 | 26,389,000 | 1,402,000 |
| Thereafter | 46,965,000 | 2,806,000 |
| | \$ 483,782,000 | \$ 16,214,000 |

(9) Series A Convertible Preferred Stock

From July 2011 through September 2012, we privately offered shares of Series A of GWG Holdings at \$7.50 per share. In the offering, we sold an aggregate of 3,278,000 shares for gross consideration of \$24,582,000. Holders of Series A were entitled to cumulative dividends at the rate of 10% per annum, paid quarterly. The Series A Convertible Preferred Stock were only redeemable at our option.

Purchasers of Series A in our offering received warrants to purchase an aggregate of 416,000 shares of our common stock at an exercise price of \$12.50 per share. As of March 31, 2018 and December 31, 2017, all of these warrants have expired and none of them had been exercised.

On October 9, 2017 all shares of Series A were redeemed with a redemption payment equal to the sum of: (i) \$8.25 per Series A share and (ii) all accrued but unpaid dividends.

(10) Redeemable Preferred Stock

On November 30, 2015, our public offering of up to 100,000 shares of Redeemable Preferred Stock ("RPS") at \$1,000 per share was declared effective. Holders of RPS are entitled to cumulative dividends at the rate of 7% per annum, paid monthly. Dividends on the RPS are recorded as a reduction to additional paid-in capital, if any, then to the outstanding balance of the preferred stock if additional paid-in-capital has been exhausted. Under certain circumstances described in the Certificate of Designation for the RPS, additional shares of RPS may be issued in lieu of cash dividends.

The RPS ranks senior to our common stock and pari passu with our RPS 2 and entitles its holders to a liquidation preference equal to the stated value per share (i.e., \$1,000) plus accrued but unpaid dividends. Holders of RPS may presently convert their RPS into our common stock at a conversion price equal to the volume-weighted average price of our common stock for the 20 trading days immediately prior to the date of conversion, subject to a minimum conversion price of \$15.00 and in an aggregate amount limited to 15% of the stated value of RPS originally purchased by such holder from us and still held by such holder.

Holders of RPS may request that we redeem their RPS at a price equal to their stated value plus accrued but unpaid dividends, less an applicable redemption fee, if any. Nevertheless, the Certificate of Designation for RPS permits us sole discretion to grant or decline redemption requests. Subject to certain restrictions and conditions, we may also redeem shares of RPS without a redemption fee upon a holder's death, total disability or bankruptcy. In addition, after one year from the date of original issuance, we may, at our option, call and redeem shares of RPS at a price equal to their liquidation preference.

GWG HOLDINGS, INC. AND SUBSIDIARIES

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(unaudited)

(10) Redeemable Preferred Stock (cont.)

As of March 31, 2017, we closed the RPS offering to investors having sold 99,127 shares of RPS for an aggregate gross consideration of \$99,127,000 and incurred approximately \$7,019,000 of related selling costs.

At the time of its issuance, we determined that the RPS contained two embedded features: (1) optional redemption by the holder and (2) optional conversion by the holder. We determined that each of the embedded features met the definition of a derivative and that the RPS should be considered an equity host for the purposes of assessing the embedded derivatives for potential bifurcation. Based on our assessment under Accounting Standards Codification 470 "Debt" ("ASC 470") we do not believe bifurcation of either the holder's redemption or conversion feature is appropriate.

(11) Series 2 Redeemable Preferred Stock

On February 14, 2017, our public offering up to 150,000 shares of Series 2 Redeemable Preferred Stock ("RPS 2") at \$1,000 per share was declared effective. Holders of RPS 2 are entitled to cumulative dividends at the rate of 7% per annum, paid monthly. Dividends on the RPS 2 are recorded as a reduction to additional paid-in capital, if any, then to the outstanding balance of the preferred stock if additional paid-in capital has been exhausted. Under certain circumstances described in the Certificate of Designation for the RPS 2, additional shares of RPS 2 may be issued in lieu of cash dividends.

The RPS 2 ranks senior to our common stock and pari passu with our RPS and entitles its holders to a liquidation preference equal to the stated value per share (i.e., \$1,000) plus accrued but unpaid dividends. Holders of RPS 2 may, less an applicable conversion discount, if any, convert their RPS 2 into our common stock at a conversion price equal to the volume-weighted average price of our common stock for the 20 trading days immediately prior to the date of conversion, subject to a minimum conversion price of \$12.75 and in an aggregate amount limited to 10% of the stated value of RPS 2 originally purchased by such holder from us and still held by such holder.

Holders of RPS 2 may request that we redeem their RPS 2 shares at a price equal to their liquidation preference, less an applicable redemption fee, if any. Nevertheless, the Certificate of Designation for RPS 2 permits us sole discretion to grant or decline requests for redemption. Subject to certain restrictions and conditions, we may also redeem shares of RPS 2 without a redemption fee upon a holder's death, total disability or bankruptcy. In addition, we may, at our option, call and redeem shares of RPS 2 at a price equal to their liquidation preference (subject to a minimum redemption price, in the event of redemptions occurring less than one year after issuance, of 107% of the stated value of the shares being redeemed).

As of March 31, 2018, we had sold 135,276 shares of RPS 2 for aggregate gross consideration of \$135,276,000 and incurred approximately \$9,300,000 of selling costs related to the sale of those shares. Subsequent to March 31, 2018, we closed the RPS 2 offering to additional investors in April 2018.

At the time of its issuance, we determined that the RPS 2 contained two embedded features: (1) optional redemption by the holder; and (2) optional conversion by the holder. We determined that each of the embedded features met the definition of a derivative and that the RPS 2 should be considered an equity host for the purposes of assessing the embedded derivatives for potential bifurcation. Based on our assessment under ASC 470 we do not believe bifurcation of either the holder's redemption or conversion feature is appropriate.

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(12) Income Taxes

We had a current income tax liability of \$0 as of both March 31, 2018 and December 31, 2017. The components of our income tax expense (benefit) and the reconciliation at the statutory federal tax rate to our actual income tax expense (benefit) for the three months ended March 31, 2018 and 2017 consisted of the following:

| | Three Months Ended March 31, 2018 | | | Three Months Ended March 31, 2017 | | |
|--|--------------------------------------|-------|----|--------------------------------------|-------|----|
| Statutory federal income tax (benefit) | \$ (1,928,000) | 21.0 | % | \$ (15,500) | 34.0 | % |
| State income taxes (benefit), net of federal benefit | (701,000) | 7.6 | % | (1,000) | 3.1 | % |
| Change in valuation allowance | 2,604,000 | (28.4 |)% | — | - | % |
| Other permanent differences | 25,000 | (0.2 |)% | 16,000 | (36.0 |)% |
| Total income tax expense (benefit) | \$ — | — | | \$ (500) | 1.1 | % |

The tax effects of temporary differences that give rise to deferred income taxes were as follows:

| | As of March 31, 2018 | As of December 31, 2017 |
|---------------------------------------|----------------------|-------------------------|
| Deferred tax assets: | | |
| Note Receivable from related party | \$ 1,437,000 | \$ 1,437,000 |
| Net operating loss carryforwards | 11,445,000 | 9,995,000 |
| Other assets | 1,641,000 | 1,724,000 |
| Subtotal | \$ 14,523,000 | \$ 13,156,000 |
| Valuation allowance | (8,990,000) | (6,386,000) |
| Deferred tax assets | \$ 5,533,000 | \$ 6,770,000 |
| Deferred tax liabilities: | | |
| Investment in life insurance policies | \$ (5,414,000) | \$ (6,630,000) |
| Other liabilities | (119,000) | (140,000) |
| Net deferred tax asset (liability) | \$ — | \$ — |

At March 31, 2018 and December 31, 2017, we had federal net operating loss (“NOL”) carryforwards of \$39,820,000 and \$34,775,000, respectively. The NOL carryforwards will begin to expire in 2031. Future utilization of NOL carryforwards is subject to limitations under Section 382 of the Internal Revenue Code. This section generally relates to a more than 50 percent change in ownership over a three-year period. We currently do not believe that any prior issuance of common stock has resulted in an ownership change under Section 382 through March 31, 2018.

We provide for a valuation allowance when it is not considered “more likely than not” that our deferred tax assets will be realized. As of March 31, 2018, based on all available evidence, we have provided a valuation allowance against our total net deferred tax asset of \$8,990,000 due to uncertainty as to the realization of our deferred tax assets during the carryforward periods.

On December 22, 2017, the U.S. federal government enacted the Tax Cuts and Jobs Act (“Tax Reform Bill”). The Tax Reform Bill changed existing United States tax law, including a reduction of the U.S. corporate income tax rate. The

Company re-measured deferred taxes as of the date of enactment, reflecting those changes within deferred tax assets as of December 31, 2017.

ASC 740 requires the reporting of certain tax positions that do not meet a threshold of “more-likely-than-not” to be recorded as uncertain tax benefits. It is management’s responsibility to determine whether it is “more-likely-than-not” that a tax position will be sustained upon examination, including resolution of any related appeals or litigation, based upon the technical merits of the position. Management has reviewed all income tax positions taken or expected to be

GWG HOLDINGS, INC. AND SUBSIDIARIES

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(12) Income Taxes (cont.)

taken for all open years and has determined that the income tax positions are appropriately stated and supported. We do not anticipate that the total unrecognized tax benefits will significantly change prior to December 31, 2018.

Under our accounting policies, interest and penalties on unrecognized tax benefits, as well as interest received from favorable tax settlements are recognized as components of income tax expense. At March 31, 2018 and December 31, 2017, we recorded no accrued interest or penalties related to uncertain tax positions.

Our income tax returns for tax years ended December 31, 2014, 2015, 2016 and 2017, when filed, remain open to examination by the Internal Revenue Service and various state taxing jurisdictions. Our income tax return for tax year ended December 31, 2013 also remains open to examination by various state taxing jurisdictions.

(13) Common Stock

In September 2014, we consummated an initial public offering of our common stock resulting in the sale of 800,000 shares of common stock at \$12.50 per share, and net proceeds of approximately \$8.6 million after the payment of underwriting commissions, discounts and expense reimbursements. In connection with this offering, we listed our common stock on the Nasdaq Capital Market under the ticker symbol "GWGH."

In conjunction with the initial public offering our Company issued warrants to purchase 16,000 shares of common stock at an exercise price of \$15.63 per share. As of March 31, 2018, none of these warrants had been exercised. The remaining life of these warrants at March 31, 2018 was 1.5 years.

(14) Stock Incentive Plan

We adopted our 2013 Stock Incentive Plan in March 2013, as amended on June 1, 2015 and May 5, 2017. The Compensation Committee of our Board of Directors is responsible for the administration of the plan. Participants under the plan may be granted incentive stock options and non-statutory stock options; stock appreciation rights; stock awards; restricted stock; restricted stock units; and performance shares. Eligible participants include officers and employees of GWG Holdings and its subsidiaries, members of our Board of Directors, and consultants. Awards generally expire 10 years from the date of grant. As of March 31, 2018, 3,000,000 common stock options are authorized under the plan, of which 869,830 remain available for issuance.

On May 8, 2018 our common shareholders approved an amendment to our 2013 Stock Incentive Plan increasing the total awards issuable under the plan to 6,000,000.

Stock Options

As of March 31, 2018, we had outstanding stock options for 1,609,000 shares of common stock to employees, officers, and directors under the plan. Options for 945,000 shares have vested, and the remaining options are scheduled to vest over three years. The options were issued with an exercise price between \$6.35 and \$10.38 for those beneficially owning more than 10% of our common stock, and between \$4.83 and \$11.00 for all others, which is equal to the market price of the shares on the date of grant. The expected annualized volatility used in the Black-Scholes model valuation of options issued during the three months ended March 31, 2018 was 20.5%. The annual volatility

rate is based on the standard deviation of the average continuously compounded rate of return of five selected comparable companies. As of March 31, 2018, stock options for 693,000 shares had been forfeited and stock options for 178,000 shares had been exercised.

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(14) Stock Incentive Plan (cont.)

Outstanding stock options:

| | Vested | Un-vested | Total |
|---------------------------------|------------|------------|------------|
| Balance as of December 31, 2016 | 738,065 | 844,334 | 1,582,399 |
| Granted during the year | 61,099 | 367,500 | 428,599 |
| Vested during the year | 327,061 | (327,061) | — |
| Exercised during the year | (126,498) | — | (126,498) |
| Forfeited during the year | (142,535) | (105,017) | (247,552) |
| Balance as of December 31, 2017 | 857,192 | 779,756 | 1,636,948 |
| Granted during the quarter | 1,000 | 3,000 | 4,000 |
| Vested during the quarter | 111,006 | (111,006) | — |
| Exercised during the quarter | (23,834) | — | (23,834) |
| Forfeited during the quarter | (750) | (7,499) | (8,249) |
| Balance as of March 31, 2018 | 944,614 | 664,251 | 1,608,865 |

As of March 31, 2018, unrecognized compensation expense related to un-vested options is \$935,000. We expect to recognize this compensation expense over the next three years (\$410,000 in 2018, \$399,000 in 2019, \$125,000 in 2020, and \$1,000 in 2021).

Stock Appreciation Rights (SARs)

As of March 31, 2018, we had outstanding SARs for 343,000 shares of the common stock to employees. The strike price of the SARs was between \$7.84 and \$10.38, which was equal to the market price of the common stock at the date of issuance. As of March 31, 2018, 194,000 of the SARs were vested. On March 31, 2018, the market price of GWG's common stock was \$8.50.

Outstanding SARs:

| | Vested | Un-vested | Total |
|---------------------------------|---------|-----------|----------|
| Balance as of December 31, 2016 | 106,608 | 133,127 | 239,735 |
| Granted during the year | 13,001 | 91,986 | 104,987 |
| Vested during the year | 69,444 | (69,444) | — |
| Forfeited during the year | — | (1,750) | (1,750) |
| Balance as of December 31, 2017 | 189,053 | 153,919 | 342,972 |
| Granted during the quarter | — | — | — |
| Vested during the quarter | 13,392 | (13,392) | — |
| Forfeited during the quarter | — | — | — |
| Balance as of March 31, 2018 | 202,445 | 140,527 | 342,972 |

The liability for the SARs as of March 31, 2018 and December 31, 2017 was \$601,000 and \$551,000, respectively, and was recorded within other accrued expenses on the condensed consolidated balance sheets. Employee compensation and benefits expense for SARs of \$50,000 and \$289,000 was recorded for the three months ended March 31, 2018 and 2017, respectively.

Upon the exercise of SARs, the Company is obligated to make cash payment equal to the positive difference between the fair market value of the Company's common stock on the date of exercise less the fair market value of the common stock on the date of grant.

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(14) Stock Incentive Plan (cont.)

The following summarizes information concerning outstanding shares issuable under the 2013 Stock Incentive Plan:

| | March 31, 2018 | | | |
|----------------|----------------|------------------------------------|---|-----------------------------|
| | Outstanding | Weighted-Average Exercise Price | Weighted-Average Remaining Life (years) | Fair Value at Grant Date |
| Vested | | | | |
| Stock Options | 944,614 | \$ 8.13 | 6.07 | \$ 1.78 |
| SARs | 202,445 | \$ 8.62 | 5.63 | \$ 1.89 |
| Total Vested | 1,147,059 | \$ 8.22 | 5.99 | \$ 1.80 |
| Unvested | | | | |
| Stock Options | 664,251 | \$ 9.32 | 7.21 | \$ 2.21 |
| SARs | 140,527 | \$ 9.11 | 6.01 | \$ 2.06 |
| Total Unvested | 804,778 | \$ 9.28 | 7.00 | \$ 2.19 |

| | December 31, 2017 | | | |
|----------------|-------------------|------------------------------------|---|-----------------------------|
| | Outstanding | Weighted-Average Exercise Price | Weighted-Average Remaining Life (years) | Fair Value at Grant Date |
| Vested | | | | |
| Stock Options | 857,192 | \$ 8.05 | 6.17 | \$ 1.76 |
| SARs | 189,053 | \$ 8.54 | 5.86 | \$ 1.90 |
| Total Vested | 1,046,245 | \$ 8.14 | 6.11 | \$ 1.78 |
| Unvested | | | | |
| Stock Options | 779,756 | \$ 9.21 | 7.50 | \$ 2.17 |
| SARs | 153,919 | \$ 9.16 | 6.24 | \$ 2.02 |
| Total Unvested | 933,675 | \$ 9.21 | 7.30 | \$ 2.15 |

(15) Other Expenses

The components of other expenses in our condensed consolidated statements of operations for the three months ended March 31, 2018 and 2017 are as follows:

| | Three Months Ended | |
|-----------------------------|--------------------|-------------------|
| | March 31, 2018 | March 31, 2017 |
| Contract labor | \$ 300,000 | \$ 95,000 |
| Marketing | 421,000 | 552,000 |
| Information technology | 500,000 | 331,000 |
| Servicing and facility fees | 394,000 | 227,000 |
| Travel and entertainment | 217,000 | 235,000 |

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| | | |
|----------------------------|--------------|--------------|
| Insurance and regulatory | 367,000 | 378,000 |
| Charitable contributions | — | 331,000 |
| General and administrative | 542,000 | 631,000 |
| Total other expenses | \$ 2,741,000 | \$ 2,780,000 |

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GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(16) Net Loss Attributable to Common Shareholders

We have outstanding RPS and RPS 2, as described in Notes 10 and 11. RPS and RPS 2 are anti-dilutive to our net loss attributable to common shareholders calculation for both the three months ended March 31, 2018 and 2017. Our vested and un-vested stock options are anti-dilutive for both the three months ended March 31, 2018 and 2017.

(17) Commitments

We are party to an office lease with U.S. Bank National Association as the landlord. On September 1, 2015, we entered into an amendment to our original lease that expanded the leased space to 17,687 square feet and extended the term through October 2025. Under the amended lease we are obligated to pay base rent plus common area maintenance and a share of building operating costs. Rent expenses under this agreement were \$104,000 and \$113,000 during the three months ended March 31, 2018 and 2017, respectively.

Minimum lease payments under the amended lease are as follows:

| | |
|--------------------------------------|--------------|
| Nine months ending December 31, 2018 | \$ 199,000 |
| 2019 | 275,000 |
| 2020 | 284,000 |
| 2021 | 293,000 |
| 2022 | 302,000 |
| 2023 | 311,000 |
| Thereafter | 593,000 |
| | \$ 2,257,000 |

(18) Contingencies

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

(19) Guarantee of L Bonds

We are publicly offering and selling L Bonds under a registration statement declared effective by the SEC, as described in Note 8. Our obligations under the L Bonds are secured by substantially all the assets of GWG Holdings, a pledge of all our common stock held individually by our largest stockholders, and by a guarantee and corresponding grant of a security interest in substantially all the assets of GWG Life. As a guarantor, GWG Life has fully and unconditionally guaranteed the payment of principal and interest on the L Bonds. GWG Life's equity in DLP IV serve as collateral for our L Bond obligations. Substantially all of our life insurance policies are held by DLP IV and the Trust. The policies held by DLP IV are not collateral for the L Bond obligations as such policies are pledged to the senior credit facility with LNV Corporation.

The consolidating financial statements are presented in lieu of separate financial statements and other related disclosures of the subsidiary guarantor 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 GWG Holdings or GWG Life, the guarantor subsidiary, to obtain funds from its subsidiaries by dividend or

loan, except as described in these notes. A substantial majority of insurance policies we currently own are subject to a collateral arrangement with LNV Corporation described in Note 6. Under this arrangement, we are required to maintain a collection account that is used to collect policy benefits from pledged policies, pay interest and other charges under the facility, and distribute funds to pay down the facility.

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(19) Guarantee of L Bonds (cont.)

The following represents condensed consolidating financial information as of March 31, 2018 and December 31, 2017, with respect to the financial position, and as of March 31, 2018 and 2017, with respect to results of operations and cash flows of GWG Holdings and its subsidiaries. The parent column presents the financial information of GWG Holdings, the primary obligor for the L Bonds. The guarantor subsidiary column presents the financial information of GWG Life, the guarantor subsidiary of the L Bonds, presenting its investment in DLP IV and the Trust under the equity method. The non-guarantor subsidiaries column presents the financial information of all non-guarantor subsidiaries, including DLP IV and the Trust.

Condensed Consolidating Balance Sheets

| March 31, 2018 | Parent | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|-----------------------|-------------------------|-------------------------------|-------------------------|-----------------------|
| <u>ASSETS</u> | | | | | |
| Cash and cash equivalents | \$ 139,933,398 | \$ 341,297 | \$ 938,212 | \$ — | \$ 141,212,907 |
| Restricted cash | — | 4,817,673 | 11,734,583 | — | 16,552,256 |
| Investment in life insurance policies, at fair value | — | 51,965,002 | 635,424,477 | — | 687,389,479 |
| Secured MCA advances | — | — | 1,639,818 | — | 1,639,818 |
| Life insurance policy benefits receivable | — | 200,000 | 12,102,730 | — | 12,302,730 |
| Other assets | 2,161,944 | 1,987,778 | 3,252,595 | — | 7,402,317 |
| Investment in subsidiaries | 505,032,023 | 446,192,147 | — | (951,224,170) | — |
| TOTAL ASSETS | \$ 647,127,365 | \$ 505,503,897 | \$ 665,092,415 | \$ (951,224,170) | \$ 866,499,507 |
| <u>LIABILITIES & STOCKHOLDERS' EQUITY</u> | | | | | |
| LIABILITIES | | | | | |
| Senior credit facility with LNV Corporation | \$ — | \$ — | \$ 209,447,613 | \$ — | \$ 209,447,613 |
| L Bonds | 469,729,977 | — | — | — | 469,729,977 |
| Accounts payable | 1,162,330 | 755,163 | 1,694,407 | — | 3,611,900 |
| Interest and dividends payable | 10,719,337 | — | 5,176,930 | — | 15,896,267 |
| Other accrued expenses | 1,768,734 | 1,788,077 | 509,952 | — | 4,066,763 |
| TOTAL LIABILITIES | 483,380,378 | 2,543,240 | 216,828,902 | — | 702,752,520 |

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| | | | | | |
|--|----------------|----------------|----------------|------------------|----------------|
| STOCKHOLDERS' | | | | | |
| EQUITY | | | | | |
| Member capital | — | 502,960,657 | 448,263,513 | (951,224,170) | — |
| Redeemable preferred stock and Series 2 redeemable preferred stock | 212,369,231 | — | — | — | 212,369,231 |
| Common stock | 5,813 | — | — | — | 5,813 |
| Accumulated deficit | (48,628,057) | — | — | — | (48,628,057) |
| TOTAL | | | | | |
| STOCKHOLDERS' | | | | | |
| EQUITY | 163,746,987 | 502,960,657 | 448,263,513 | (951,224,170) | 163,746,987 |
| TOTAL LIABILITIES | | | | | |
| AND | | | | | |
| STOCKHOLDERS' | | | | | |
| EQUITY | \$ 647,127,365 | \$ 505,503,897 | \$ 665,092,415 | \$ (951,224,170) | \$ 866,499,507 |
| 21 | | | | | |

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(19) Guarantee of L Bonds (cont.)

Condensed Consolidating Balance Sheets (continued)

| December 31, 2017 | Parent | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|-----------------------|-------------------------|-------------------------------|-------------------------|-----------------------|
| <u>ASSETS</u> | | | | | |
| Cash and cash equivalents | \$ 111,952,829 | \$ 1,486,623 | \$ 982,039 | \$ — | \$ 114,421,491 |
| Restricted cash | — | 9,367,410 | 18,982,275 | — | 28,349,685 |
| Investment in life insurance policies, at fair value | — | 51,093,362 | 599,433,991 | — | 650,527,353 |
| Secured MCA advances | — | — | 1,661,774 | — | 1,661,774 |
| Life insurance policy benefits receivable | — | 1,500,000 | 15,158,761 | — | 16,658,761 |
| Other assets | 1,912,203 | 1,986,312 | 3,338,595 | — | 7,237,110 |
| Investment in subsidiaries | 480,659,789 | 415,235,212 | — | (895,895,001) | — |
| TOTAL ASSETS | \$ 594,524,821 | \$ 480,668,919 | \$ 639,557,435 | \$ (895,895,001) | \$ 818,856,174 |
| <u>LIABILITIES & STOCKHOLDERS' EQUITY</u> | | | | | |
| LIABILITIES | | | | | |
| Senior credit facility with LNV Corporation | \$ — | \$ — | \$ 212,238,192 | \$ — | \$ 212,238,192 |
| L Bonds | 447,393,568 | — | — | — | 447,393,568 |
| Accounts payable | 1,434,623 | 844,899 | 4,114,917 | — | 6,394,439 |
| Interest and dividends payable | 10,296,584 | — | 5,130,925 | — | 15,427,509 |
| Other accrued expenses | 1,728,303 | 1,610,773 | 391,647 | — | 3,730,723 |
| TOTAL LIABILITIES | 460,853,078 | 2,455,672 | 221,875,681 | — | 685,184,431 |
| STOCKHOLDERS' EQUITY | | | | | |
| Member capital | — | 478,213,247 | 417,681,754 | (895,895,001) | — |
| Redeemable preferred stock and Series 2 redeemable preferred stock | 173,115,447 | — | — | — | 173,115,447 |
| Common stock | 5,813 | — | — | — | 5,813 |
| Accumulated deficit | (39,449,517) | — | — | — | (39,449,517) |

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| | | | | | |
|---|----------------|----------------|----------------|------------------|----------------|
| TOTAL STOCKHOLDERS' EQUITY | 133,671,743 | 478,213,247 | 417,681,754 | (895,895,001) | 133,671,743 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 594,524,821 | \$ 480,668,919 | \$ 639,557,435 | \$ (895,895,001) | \$ 818,856,174 |

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GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(19) Guarantee of L Bonds (cont.)

Condensed Consolidating Statements of Operations

| For the three months ended March 31, 2018 | Parent | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|------------------------|---------------------------------|---------------------------------------|------------------------|------------------------|
| REVENUE | | | | | |
| Gain on life insurance policies, net | \$ — | \$ 1,393,455 | \$ 12,475,290 | \$ — | \$ 13,868,745 |
| MCA income | — | — | 66,810 | — | 66,810 |
| Interest and other income | 452,039 | 8,726 | 145,352 | — | 606,117 |
| TOTAL REVENUE | 452,039 | 1,402,181 | 12,687,452 | — | 14,541,672 |
| EXPENSES | | | | | |
| Interest expense | 10,622,652 | — | 5,440,685 | — | 16,063,337 |
| Employee compensation and benefits | 1,922,733 | 1,475,731 | 344,205 | — | 3,742,669 |
| Legal and professional fees | 407,312 | 231,650 | 534,667 | — | 1,173,629 |
| Other expenses | 1,794,480 | 464,607 | 481,490 | — | 2,740,577 |
| TOTAL EXPENSES | 14,747,177 | 2,171,988 | 6,801,047 | — | 23,720,212 |
| INCOME (LOSS) BEFORE EQUITY IN INCOME OF SUBSIDIARIES | (14,295,138) | (769,807) | 5,886,405 | — | (9,178,540) |
| EQUITY IN INCOME OF SUBSIDIARIES | 5,116,598 | 6,864,200 | — | (11,980,798) | — |
| NET INCOME (LOSS) BEFORE INCOME TAXES | (9,178,540) | 6,094,393 | 5,886,405 | (11,980,798) | (9,178,540) |
| INCOME TAX BENEFIT | — | — | — | — | — |
| NET INCOME (LOSS) | (9,178,540) | 6,094,393 | 5,886,405 | (11,980,798) | (9,178,540) |
| Preferred stock dividends | 3,704,484 | — | — | — | 3,704,484 |
| NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS | \$ (12,883,024) | \$ 6,094,393 | \$ 5,886,405 | \$ (11,980,798) | \$ (12,883,024) |
| For the three months ended March 31, 2017 | | | | | |
| REVENUE | Parent | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| Gain on life insurance policies, net | \$ — | \$ 1,499,327 | \$ 17,900,492 | \$ — | \$ 19,399,819 |

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| | | | | | |
|---|-----------------|---------------|---------------|-----------------|-----------------|
| MCA income | — | — | 246,577 | — | 246,577 |
| Interest and other income | 85,008 | 71,900 | 379,086 | (94,045) | 441,949 |
| TOTAL REVENUE | 85,008 | 1,571,227 | 18,526,155 | (94,045) | 20,088,345 |
| EXPENSES | | | | | |
| Interest expense | 9,262,034 | 286,354 | 3,736,847 | (41,020) | 13,244,215 |
| Employee compensation and benefits | 1,928,796 | 1,221,582 | 12,684 | — | 3,163,062 |
| Legal and professional fees | 492,816 | 261,087 | 192,445 | — | 946,348 |
| Other expenses | 1,663,002 | 882,731 | 287,614 | (53,025) | 2,780,322 |
| TOTAL EXPENSES | 13,346,648 | 2,651,754 | 4,229,590 | (94,045) | 20,133,947 |
| INCOME (LOSS) BEFORE EQUITY IN INCOME OF SUBSIDIARIES | | | | | |
| | (13,261,640) | (1,080,527) | 14,296,565 | — | (45,602) |
| EQUITY IN INCOME OF SUBSIDIARIES | | | | | |
| | 13,216,038 | 14,064,207 | — | (27,280,245) | — |
| NET INCOME (LOSS) BEFORE INCOME TAXES | | | | | |
| | (45,602) | 12,983,680 | 14,296,565 | (27,280,245) | (45,602) |
| INCOME TAX BENEFIT | | | | | |
| | (500) | — | — | — | (500) |
| NET INCOME (LOSS) | | | | | |
| | (45,102) | 12,983,680 | 14,296,565 | (27,280,245) | (45,102) |
| Preferred stock dividends | | | | | |
| | 1,867,760 | — | — | — | 1,867,760 |
| NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS | | | | | |
| | \$ (1,912,862) | \$ 12,983,680 | \$ 14,296,565 | \$ (27,280,245) | \$ (1,912,862) |

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(19) Guarantee of L Bonds (cont.)

Condensed Consolidating Statements of Cash Flows

| For the three months ended March 31, 2018 | Parent | Guarantor Subsidiary | Non-Guarantor Subsidiary | Eliminations | Consolidated |
|--|----------------------|---------------------------------|-------------------------------------|---------------------|----------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | | |
| Net income (loss) | \$ (9,178,540) | \$ 6,094,393 | \$ 5,886,405 | \$ (11,980,798) | \$ (9,178,540) |
| Adjustments to reconcile net income (loss) to net cash flows from operating activities: | | | | | |
| Equity of subsidiaries | (5,116,598) | (6,864,200) | — | 11,980,798 | — |
| Changes in fair value of life insurance policies | — | (1,512,185) | (15,133,409) | — | (16,645,594) |
| Amortization of deferred financing and issuance costs | 1,999,433 | — | 263,755 | — | 2,263,188 |
| (Increase) decrease in operating assets: | | | | | |
| Life insurance policy benefits receivable | — | 1,300,000 | 3,056,031 | — | 4,356,031 |
| Other assets | (19,505,377) | (24,094,201) | 86,000 | 43,348,371 | (165,207) |
| Increase (decrease) in operating liabilities: | | | | | |
| Accounts payable and other accrued expenses | 690,234 | 87,568 | (2,323,010) | — | (1,545,208) |
| NET CASH FLOWS USED IN OPERATING ACTIVITIES | (31,110,848) | (24,988,625) | (8,164,228) | 43,348,371 | (20,915,330) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | | |
| Investment in life insurance policies | — | — | (25,299,825) | — | (25,299,825) |
| Carrying value of matured life insurance policies | — | 640,545 | 4,442,749 | — | 5,083,294 |
| Proceeds from Secured MCA advances | — | — | 88,766 | — | 88,766 |
| NET CASH FLOWS PROVIDED BY (USED IN) INVESTING | — | 640,545 | (20,768,310) | — | (20,127,765) |

ACTIVITIES

**CASH FLOWS FROM
FINANCING
ACTIVITIES**

| | | | | | |
|--|-----------------------|---------------------|----------------------|---------------------|-----------------------|
| Net repayments of senior credit facility | — | — | (3,054,335) | — | (3,054,335) |
| Proceeds from issuance of L Bonds | 36,661,099 | — | — | — | 36,661,099 |
| Payment for redemption and issuance of L Bonds | (12,245,448) | — | — | — | (12,245,448) |
| Proceeds from issuance of preferred stock | 41,865,169 | — | — | — | 41,865,169 |
| Payments for issuance of preferred stock | (3,157,695) | — | — | — | (3,157,695) |
| Payments for redemption of preferred stock | (327,224) | — | — | — | (327,224) |
| Preferred stock dividends | (3,704,484) | — | — | — | (3,704,484) |
| Issuance of member capital | — | 18,653,017 | 24,695,354 | (43,348,371) | — |
| NET CASH FLOWS PROVIDED BY FINANCING ACTIVITIES | 59,091,417 | 18,653,017 | 21,641,019 | (43,348,371) | 56,037,082 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 27,980,569 | (5,695,063) | (7,291,519) | — | 14,993,987 |
| CASH AND CASH EQUIVALENTS AND RESTRICTED CASH BEGINNING OF THE PERIOD | 111,952,829 | 10,854,033 | 19,964,314 | — | 142,771,176 |
| END OF THE PERIOD | \$ 139,933,398 | \$ 5,158,970 | \$ 12,672,795 | \$ — | \$ 157,765,163 |

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GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(19) Guarantee of L Bonds (cont.)

Condensed Consolidating Statements of Cash Flows (continued)

| For the three months ended March 31, 2017 | Parent | Guarantor Subsidiary | Non-Guarantor Subsidiary | Eliminations | Consolidated |
|--|--------------|-------------------------|-----------------------------|-----------------|---------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | | |
| Net income (loss) | \$ (45,102) | \$ 12,983,680 | \$ 14,296,565 | \$ (27,280,245) | \$ (45,102) |
| Adjustments to reconcile net income (loss) to net cash flows from operating activities: | | | | | |
| (Equity) of subsidiaries | (13,216,038) | (14,064,207) | — | 27,280,245 | — |
| Changes in fair value of life insurance policies | — | (1,059,422) | (12,824,411) | — | (13,883,833) |
| Amortization of deferred financing and issuance costs | 1,928,993 | 45,420 | 691,790 | — | 2,666,203 |
| Deferred income taxes | (500) | — | — | — | (500) |
| (Increase) decrease in operating assets: | | | | | |
| Life insurance policy benefits receivable | — | (600,000) | (3,030,000) | — | (3,630,000) |
| Other assets | 5,507,945 | (32,041,085) | 755,219 | 27,204,239 | 1,426,318 |
| Increase (decrease) in operating liabilities: | | | | | |
| Accounts payable and other accrued expenses | 1,453,622 | (158,412) | 250,996 | — | 1,546,206 |
| NET CASH FLOWS USED IN OPERATING ACTIVITIES | (4,371,080) | (34,894,026) | 140,159 | 27,204,239 | (11,920,708) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | | |
| Investment in life insurance policies | — | — | (22,689,333) | — | (22,689,333) |
| Carrying value of matured life insurance policies | — | 495,424 | 1,873,550 | — | 2,368,974 |
| Proceeds from Secured MCA advances | — | — | 770,387 | — | 770,387 |
| NET CASH FLOWS PROVIDED BY (USED) | — | 495,424 | (20,045,396) | — | (19,549,972) |

IN) INVESTING
ACTIVITIES**CASH FLOWS FROM
FINANCING
ACTIVITIES**

| | | | | | |
|--|----------------------|---------------------|----------------------|---------------------|----------------------|
| Net repayments of senior credit facility | — | — | (3,368,794) | — | (3,368,794) |
| Payments for redemption of Series I Secured Notes | — | (5,449,889) | — | — | (5,449,889) |
| Proceeds from issuance of L Bonds | 24,868,659 | — | — | — | 24,868,659 |
| Payment for redemption and issuance of L Bonds | (24,171,597) | — | — | — | (24,171,597) |
| Repurchase of common stock | (1,603,560) | — | — | — | (1,603,560) |
| Proceeds from issuance of preferred stock | 27,179,194 | — | — | — | 27,179,194 |
| Payments for issuance of preferred stock | (2,017,487) | — | — | — | (2,017,487) |
| Payments for redemption of preferred stock | (386,739) | — | — | — | (386,739) |
| Preferred stock dividends | (1,867,760) | — | — | — | (1,867,760) |
| Issuance of member capital | — | (5,218,339) | 32,422,578 | (27,204,239) | — |
| NET CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES | 22,000,710 | (10,668,228) | 29,053,784 | (27,204,239) | 13,182,027 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 17,629,630 | (45,066,830) | 9,148,547 | — | (18,288,653) |
| CASH AND CASH EQUIVALENTS AND RESTRICTED CASH BEGINNING OF THE PERIOD | 28,481,047 | 51,478,601 | 36,353,930 | — | 116,313,578 |
| END OF THE PERIOD | \$ 46,110,677 | \$ 6,411,771 | \$ 45,502,477 | \$ — | \$ 98,024,925 |

GWG HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(20) Concentration

We mostly purchase life insurance policies written by life insurance companies having investment-grade ratings by independent rating agencies. As a result, there may be certain concentrations of policies with life insurance companies. The following summarizes the face value of insurance policies with specific life insurance companies exceeding 10% of the total face value held by our portfolio.

| | March 31, | | December 31, 2017 | |
|------------------------|-----------|---|-------------------|---|
| Life insurance company | 2018 | | | |
| John Hancock | 15.13 | % | 15.57 | % |
| AXA Equitable | 11.55 | % | 11.88 | % |
| Lincoln National | 11.07 | % | 10.80 | % |

The following summarizes the number of insured state of residence exceeding 10% of the total face value held by us:

| | March 31, | | December 31, 2017 | |
|--------------------|-----------|---|-------------------|---|
| State of residence | 2018 | | | |
| Florida | 20.17 | % | 20.16 | % |
| California | 18.58 | % | 18.60 | % |

(21) Subsequent Events

Subsequent to March 31, 2018, two policies covering two individuals have matured. The combined insurance benefits of these policies were \$1,495,000.

Subsequent to March 31, 2018, we have issued approximately \$26,006,000 of L Bonds.

Subsequent to March 31, 2018, we have issued approximately \$14,312,000 of RPS 2. We closed the RPS 2 offering to additional investors in April 2018.

On April 30, 2018, we entered into a First Amendment to the Master Exchange Agreement with The Beneficiary Company Group, L.P., MHT Financial SPV, LLC, and various related trusts. Prior to the amendment under the Master Exchange Agreement, we, on the one hand, and The Beneficiary Company Group, L.P., MHT Financial SPV, LLC, and the various related trusts, on the other hand, could terminate the Master Exchange Agreement prior to the closing under certain circumstances, including if the conditions to closing of the transaction had not been fulfilled by April 30, 2018 (the "Closing Conditions Date"). The amendment extended the Closing Conditions Date until June 30, 2018. All other terms remain the same. The Master Exchange Agreement, as amended and restated on January 18, 2018 with effect from January 12, 2018, and the First Amendment to the Master Exchange Agreement are filed herewith.

On May 9, 2018 we learned that John Hancock Life Insurance Company ("John Hancock") has begun sending notices of cost-of-insurance increases on Performance UL policies issued between 2003 and 2010. We currently hold 15 of such issued policies representing a total of \$49,500,000 in policy benefits and accounting for 3.7% of the fair value of our portfolio as of March 31, 2018. We have not received any notices from John Hancock and will continue to monitor carrier communications to identify affected policies for further analysis.

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

You should read the following discussion in conjunction with the condensed consolidated financial statements and accompanying notes and the information contained in other sections of this report. This discussion and analysis is based on the beliefs of our management, as well as assumptions made by, and information currently available to, our management.

Risk Relating to Forward-Looking Statements

This report contains forward-looking statements that reflect our current expectations and projections about future events. Actual results could differ materially from those described in these forward-looking statements.

The words "believe," "could," "possibly," "probably," "anticipate," "estimate," "project," "expect," "may," "will," "should," "plan," "expect," or "consider" and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. Forward-looking statements are subject to risks and uncertainties, which could cause actual results to differ materially from such statements. Many of the forward-looking statements contained in this report can be found in our MD&A discussion.

Such risks and uncertainties include, but are not limited to:

- changes in the secondary market for life insurance;
- changes resulting from the evolution of our business model and strategy with respect to the life insurance industry;
- our limited operating history;
- the valuation of assets reflected on our financial statements;
- the reliability of assumptions underlying our actuarial models, including our life expectancy estimates;
- our reliance on debt financing and continued access to the capital markets;
- our history of operating losses;
- risks relating to the validity and enforceability of the life insurance policies we purchase;
- risks relating to our ability to license and effectively apply technologies to improve and expand the scope of our business;
- our reliance on information provided and obtained by third parties;
- federal, state and FINRA regulatory matters;
- competition in the secondary market of life insurance;
- the relative illiquidity of life insurance policies;
- our ability to satisfy our debt obligations if we were to sell our entire portfolio of life insurance policies;

- life insurance company credit exposure;
- cost-of-insurance (premium) increases on our life insurance policies;
- general economic outlook, including prevailing interest rates;
- performance of our investments in life insurance policies;
- financing requirements;
- risks associated with the merchant cash advance business;
- the various risks associated with our attempts to commercialize our M-Panel technology;
- risks associated with our ability to protect our intellectual property rights;

- litigation risks;
- restrictive covenants contained in borrowing agreements;
- our ability to make cash distributions in satisfaction of dividend obligations and redemption requests; and
- our ability to complete our contemplated securities exchange transaction with The Beneficient Company Group, L.P. within our anticipated timeframe or at all, or on the terms and conditions presently set forth in the Master Exchange Agreement that governs the transaction.

We caution you that the foregoing list of factors is not exhaustive. Forward-looking statements are only estimates and predictions, or statements of current intent. Actual results, outcomes or actions that we ultimately undertake could differ materially from those anticipated in the forward-looking statements due to risks, uncertainties or actual events differing from the assumptions underlying these statements.

JOBS Act

On April 5, 2012, the Jumpstart Our Business Startups Act of 2012, or JOBS Act, was enacted. Section 107 of the JOBS Act provides that an “emerging growth company” can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act of 1933 for complying with new or revised accounting standards. This means that an “emerging growth company” can make an election to delay the adoption of certain accounting standards until those standards would apply to private companies. We are an emerging growth company and have elected to delay our adoption of new or revised accounting standards and, as a result, we may not comply with new or revised accounting standards at the same time as other public reporting companies that are not “emerging growth companies.” This exemption will apply for a period of five years following our first sale of common equity securities under an effective registration statement or until we no longer qualify as an “emerging growth company” (September 2019) as defined under the JOBS Act, whichever is earlier.

Overview

We are a financial services company committed to disrupting and transforming the life insurance and related industries. We built our business by creating opportunities for consumers to obtain significantly more value for their life insurance policies in a secondary market as compared to the traditional options offered by the insurance industry. We are enhancing and extending our activities in the life insurance industry through innovation in our products and services, business processes, financing strategies, and advanced epigenetic technologies. At the same time, we are creating opportunities for investors to receive income and capital appreciation from our investment activities in the life insurance and related industries.

In January 2018, we entered into a Master Exchange Agreement (as it may be amended from time to time, the “Master Agreement”) to govern a strategic relationship with The Beneficient Company Group, L.P. (“Beneficient”), among others, that we expect will provide a significant increase in our assets, common shareholder equity and earnings. We collectively refer in this report to the transactions contemplated by the Master Agreement as the “Exchange Transaction.” Information regarding Beneficient and the Exchange Transaction is set forth in Item 1 (Business) of our Annual Report on Form 10-K for the year ended December 31, 2017, and in Item 1A (Risk Factors) of such Annual Report under the caption “Risks Related to the Pending Exchange Transaction.”

On April 30, 2018, we entered into a First Amendment to the Master Exchange Agreement. Prior to the amendment, we and Beneficient, among others, could terminate the Master Agreement prior to the closing under certain circumstances, including if the conditions to closing of the transaction had not been fulfilled by April 30, 2018 (the “Closing Conditions Date”). The First Amendment extended the Closing Conditions Date until June 30, 2018. The Exchange Transaction is currently expected to close in the second quarter of 2018.

Critical Accounting Policies

Critical Accounting Estimates

The preparation of our consolidated financial statements in accordance with the Generally Accepted Accounting Principles in the United States of America (GAAP) requires us to make significant judgments, estimates, and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our judgments, estimates, and assumptions on historical experience and on various other factors believed to be reasonable under the circumstances. Actual results could differ

materially from these estimates. We evaluate our judgments, estimates, and assumptions on a regular basis and make changes accordingly. We believe that the judgments, estimates, and assumptions involved in valuing our investments in life insurance policies and evaluating deferred taxes have the greatest potential impact on our consolidated financial statements and accordingly believe these to be our critical accounting estimates. Below we discuss the critical accounting policies associated with these estimates as well as certain other critical accounting policies.

Ownership of Life Insurance Policies — Fair Value Option

We account for the purchase of life insurance policies in accordance with Accounting Standards Codification 325-30, Investments in Insurance Contracts, which requires us to use either the investment method or the fair value method. We have elected to account for all of our life insurance policies using the fair value method.

The fair value of our life insurance policies is determined as the net present value of the life insurance portfolio's future expected cash flows (policy benefits received and required premium payments) that incorporates current life expectancy estimates and discount rate assumptions.

We initially record our purchase of life insurance policies at the transaction price, which is the amount paid for the policy, inclusive of all external fees and costs associated with the acquisition. At each subsequent reporting period, we re-measure the investment at fair value in its entirety and recognize the change in fair value as unrealized gain (revenue) in the current period, net of premiums paid. Changes in the fair value of our portfolio are based on periodic evaluations and are recorded in our consolidated statements of operations as changes in fair value of life insurance policies.

Fair Value Components — Life Expectancies

Unobservable inputs, as discussed below, are a critical component of our estimate for the fair value of our investments in life insurance policies. We currently use a probabilistic method of estimating and valuing the projected cash flows of our portfolio, which we believe to be the preferred and most prevalent valuation method in the industry. In this regard, the most significant assumptions we make are the life expectancy estimates of the insureds and the discount rate applied to the expected future cash flows to be derived from our portfolio.

The 2015 Valuation Basic Table ("2015 VBT") finalized by the Society of Actuaries is based on a much larger dataset of insured lives, face amount of policies and more current information compared to the dataset underlying the 2008 Valuation Basic Table. The 2015 VBT dataset includes 266 million policies compared to the 2008 VBT dataset of 75 million. The experience data in the 2015 VBT dataset includes 2.55 million claims on policies from 51 insurance carriers. Life expectancies implied by the 2015 VBT are generally longer for male and female nonsmokers between the ages of 65 and 80, while smokers and insureds of both genders over the age of 85 have significantly lower life expectancies. We adopted the 2015 VBT in our valuation process in 2016.

For life insurance policies with face amounts greater than \$1 million and that are not pledged under any senior credit facility (approximately 14.6% of our portfolio by face amount of policy benefits) we attempt to update the life expectancy estimates on a continuous rotating three year cycle. For life insurance policies that are pledged under the LNV senior credit facility (approximately 78.1% of our portfolio by face amount of policy benefits) we are presently required to update the life expectancy estimates every two years beginning from the date of the amended facility. For the remaining small face insurance policies (i.e., a policy with \$1 million in face value benefits or less) we may employ a range of methods and timeframes to update life expectancy estimates.

We conduct medical underwriting on the life insurance policies we own with life expectancy reports produced by independent third-party medical-actuarial underwriting firms. Each life expectancy report summarizes the underlying insured person's medical history based on the underwriter's review of recent and historical medical records. We obtain two such life expectancy reports for almost all policies, except for small face value insurance policies (i.e., a policy

with \$1 million in face value benefits or less) for which we have obtained at least one fully underwritten or simplified third-party report. A simplified third-party underwriting report is based on a medical interview, which may be supplemented with additional information obtained from a pharmacy benefit manager database. For valuation purposes, we use the life expectancy estimate, using the average, in the case of multiple reports, expressed as the number of months at which the individual will have a 50% probability of mortality.

Our prior experience in updating life expectancy estimates has generally resulted in shorter life expectancies of the updated insureds within our portfolio, but often not as short as we had projected. This has resulted in reductions to the fair value of our portfolio in the amounts of \$4.9 million and \$1.9 million for the three months ended March 31, 2018 and 2017, respectively. As our life insurance portfolio continues to grow, we may experience additional and material adjustments to the fair value of our portfolio due to updating life expectancy estimates.

Fair Value Components — Required Premium Payments

We must pay the premiums on the life insurance policies within our portfolio in order to collect the policy benefit. The same probabilistic model and methodologies used to generate expected cash inflows from the life insurance policy benefits over the expected life of the insured are used to estimate cash outflows due to required premium payments. Premiums paid are offset against revenue in the applicable reporting period.

Fair Value Components — Discount Rate

A discount rate is used to calculate the net present value of the expected cash flows. The discount rate used to calculate fair value of our portfolio incorporates the guidance provided by Accounting Standards Codification 820, Fair Value Measurements and Disclosures.

The table below provides the discount rate used to estimate the fair value of our portfolio of life insurance policies for the period ending:

| | |
|----------------------|----------------------|
| March 31, 2018 | December 31, 2017 |
| 10.45% | 10.45% |

The discount rate incorporates current information about discount rates applied by other reporting companies owning portfolios of life insurance policies, discount rates observed by us in the life insurance secondary market, market interest rates, credit exposure to the issuing insurance companies, and our estimate of the operational risk premium a purchaser would require to receive the future cash flows derived from our portfolio of life insurance policies. Management has discretion regarding the combination of these and other factors when determining the discount rate. The discount rate we choose assumes an orderly and arms-length transaction (i.e., a non-distressed transaction in which neither seller nor buyer is compelled to engage in the transaction), which is consistent with related GAAP guidance. The carrying value of policies acquired during each quarterly reporting period are adjusted to their current fair value using the fair value discount rate applied to the entire portfolio as of that reporting date.

We engaged Model Actuarial Pricing System, LP. (“MAPS”), owner of the actuarial portfolio pricing software we use, to prepare a calculation of our life insurance portfolio. MAPS processed policy data, future premium data, life expectancy estimate data, and other actuarial information to calculate a net present value for our portfolio using the specified discount rate of 10.45%. MAPS independently calculated the net present value of our portfolio of 942 policies to be \$687.4 million and furnished us with a letter documenting its calculation. A copy of such letter is filed as Exhibit 99.1 to this report.

Deferred Income Taxes

Under Accounting Standards Codification 740, Income Taxes (“ASC 740”), deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A valuation allowance is established for deferred tax assets that are not considered “more likely than not” to be realized. Realization of deferred tax assets depends upon having sufficient past or future taxable income in periods to which the deductible temporary differences are expected to be recovered or within any applicable carryback or carryforward periods or sufficient tax planning strategies. After assessing the realization of the net deferred tax assets, we believe that there is substantial uncertainty that our net deferred tax asset will be realized during the applicable carryforward period. As such, a valuation allowance has been established against the total net deferred tax asset as of March 31, 2018 and December 31, 2017, respectively.

Principal Revenue and Expense Items

We earn revenues from the following three primary sources.

- **Life Insurance Policy Benefits Realized.** We recognize the difference between the face value of the policy benefits and carrying value when an insured event has occurred and determine that collection of the policy benefits is realizable and reasonably assured. Revenue from a transaction must meet both criteria in order to be recognized. We generally collect the face value of the life insurance policy from the insurance company within 45 days of our notification of the insured's mortality.
- **Change in Fair Value of Life Insurance Policies.** We value our portfolio investments for each reporting period in accordance with the fair value principles discussed herein, which reflects the expected receipt of policy benefits in future periods, net of premium costs, as shown in our condensed consolidated financial statements.
- **Sale of a Life Insurance Policy.** In the event of a sale of a policy, we recognize 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.

Our main components of expense are summarized below.

- **Selling, General and Administrative Expenses.** We recognize and record expenses incurred in our business operations, including operations related to the purchasing and servicing of life insurance policies. These expenses include salaries and benefits, sales, marketing, occupancy and other expenditures.
- **Interest Expense.** We recognize, and record interest expenses associated with the costs of financing our life insurance portfolio for the current period. These expenses include interest paid to our senior lenders under our senior credit facility with LNV Corporation, interest paid on our L Bonds and other outstanding indebtedness. When we issue debt, we amortize the financing costs (commissions and other fees) associated with such indebtedness over the outstanding term of the financing and classify it as interest expense.

Results of Operations — Three Months Ended March 31, 2018 Compared to the Same Period in 2017

The following is our analysis of the results of operations for the periods indicated below. This analysis should be read in conjunction with our condensed consolidated financial statements and related notes.

Revenue.

| | Three Months Ended March 31, 2018 | 2017 |
|---|---|------------------|
| Revenue recognized from maturities of life insurance policies | \$ 9,421,000 | \$ 16,606,000 |
| Revenue recognized from change in fair value of life insurance policies | 16,645,000 | 13,884,000 |
| Premiums and other annual fees | \$ (12,197,000) | \$ (11,090,000) |
| Gain on life insurance policies, net | 13,869,000 | 19,400,000 |
| Other income | 673,000 | 688,000 |
| Total revenue | \$ 14,542,000 | \$ 20,088,000 |
| Number of policies matured | 15 | 10 |
| Face value of matured policies | \$ 14,504,000 | \$ 18,975,000 |
| The change in fair value related to new policies acquired during the period | \$ 6,974,000 | \$ 10,602,000 |

The discount rate applied to estimate the fair value of the portfolio of life insurance policies we own was 10.45% and 10.96% as of March 31, 2018 and 2017, respectively. The carrying value of policies acquired during each quarterly reporting period is adjusted to current fair value using the fair value discount rate applied to the entire portfolio as of that reporting date.

Expenses.

| | Three Months Ended March 31, 2018 | 2017 | Increase/Decrease |
|---|--------------------------------------|---------------|-------------------|
| Interest expense (including amortization of deferred financing costs) | \$ 16,063,000 | \$ 13,244,000 | \$ 2,819,000 (1) |
| Employee compensation and benefits | 3,743,000 | 3,163,000 | 580,000 (2) |
| Legal and professional expenses | 1,173,000 | 947,000 | 226,000 (3) |
| Other expenses | 2,741,000 | 2,780,000 | (39,000)(4) |
| Total expenses | \$ 23,720,000 | \$ 20,134,000 | \$ 3,586,000 |

- (1) Increase is due to the increase in our average debt outstanding from approximately \$560.1 million during the three months ended March 31, 2017 to approximately \$690.4 million during the same period of 2018, as well as the increase of the senior credit facility with LNV Corporation interest rate from 7.47% to 9.63% for the three months ended March 31, 2017 and 2018, respectively.
- (2) Increase is due to hiring of additional members to our sales and policy acquisition teams. At March 31, 2018 we employed 63 employees and on March 31, 2017 we employed 70 employees.
- (3) Increase is due to increased legal fees associated with MCA collections.
- (4) Increased costs in information technology, servicing and facility fees, and contract labor costs were offset by a reduction in charitable contributions and marketing costs. See Note 15 for detailed breakdown.

Deferred Income Taxes.

Under ASC 740, Income Taxes (“ASC 740”), deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A valuation allowance is established for deferred tax assets that are not considered “more likely than not” to be realized. Realization of deferred tax assets depends upon having sufficient past or future taxable income in periods to which the deductible temporary differences are expected to be recovered or within any applicable carryback or carryforward periods. After assessing the realization of the net deferred tax assets, we believe that there is substantial uncertainty that our net deferred tax asset will be realized during the applicable carryforward period. As such, a valuation allowance has been established against the total net deferred tax asset as of March 31, 2018 and December 31, 2017.

Income Tax Expense.

We realized income tax benefit of \$0 and \$500 for the three months ended March 31, 2018 and 2017, respectively. The effective rate for the three months ended March 31, 2018 and 2017 were 0% and 1.1%, respectively, compared to expected statutory rate of 21.0% and 34.0%, respectively.

The following table provides a reconciliation of our income tax expense at the statutory federal tax rate to our actual income tax expense:

| | Three Months Ended March 31, 2018 | | | 2017 | | |
|--|--------------------------------------|-------|----|--------------|-------|----|
| Statutory federal income tax (benefit) | \$ (1,928,000) | 21.0 | % | \$ (15,500) | 34.0 | % |
| State income taxes (benefit), net of federal benefit | (701,000) | 7.6 | % | (1,000) | 3.1 | % |
| Valuation allowance | 2,604,000 | (28.4 |)% | — | | % |
| Other permanent differences | 25,000 | (0.2 |)% | 16,000 | (36.0 |)% |
| Total income tax expense (benefit) | \$ — | 0.0 | % | \$ (500) | 1.1 | % |

The Tax Reform Bill enacted by U.S. Federal government in December 2017 changed existing tax law including a reduction of the U.S. Corporate tax rate. The Company re-measured deferred taxes as of the date of enactment, reflecting these changes within deferred tax assets as of December 31, 2017.

The most significant temporary differences between GAAP net income (loss) and taxable net income (loss) are the treatment of interest costs, policy premiums and servicing costs with respect to the acquisition and maintenance of the life insurance policies and revenue recognition with respect to the fair value of the life insurance portfolio.

Liquidity and Capital Resources

We finance our businesses through a combination of life insurance policy benefit receipts, equity offerings, debt offerings, and our senior credit facility. We have used our debt offerings and our senior credit facility for policy acquisition, policy premiums and servicing costs, working capital and financing expenditures including paying principal, interest and dividends.

As of March 31, 2018 and December 31, 2017, we had approximately \$170.1 million and \$159.4 million, respectively, in combined available cash, cash equivalents, and policy benefits receivable for the purpose of purchasing additional life insurance policies, paying premiums on existing policies, paying portfolio servicing expenses, and paying principal, interest and dividends on our outstanding debt and equity securities. Additional future borrowing base capacity for premiums and servicing costs, created as the premiums and servicing costs of pledged life

insurance policies become due and by additional policy pledges to the facility or not, exists under the amended and restated senior credit facility with LNV Corporation.

Financings Summary

We had the following outstanding debt balances as of March 31, 2018 and December 31, 2017:

| Issuer/Borrower | As of March 31, 2018 | | | As of December 31, 2017 | | |
|---|------------------------------|--------------------------------|---|------------------------------|--------------------------------|---|
| | Principal Amount Outstanding | Weighted Average Interest Rate | | Principal Amount Outstanding | Weighted Average Interest Rate | |
| GWG Holdings, Inc. – L Bonds (see Note 8) | \$ 483,782,000 | 7.24 | % | \$ 461,427,000 | 7.29 | % |
| GWG DLP Funding IV, LLC – LNV senior credit facility (see Note 6) | 219,470,000 | 9.63 | % | 222,525,000 | 9.31 | % |
| Total | \$ 703,252,000 | 7.99 | % | \$ 683,952,000 | 7.95 | % |

In November 2011, we began offering Series I Secured Notes, which were governed by an Intercreditor Agreement, a Third Amended and Restated Note Issuance and Security Agreement dated November 1, 2011, as amended, and a related Pledge Agreement. In September 2017, all of the Series I Secured Notes were paid in full and all obligations thereunder were terminated.

In June 2011, we concluded a private placement offering of Series A Preferred Stock for new investors, having received an aggregate \$24.6 million in subscriptions for our Series A Preferred Stock. These subscriptions consisted of \$14.0 million in conversions of outstanding Series I Secured Notes into Series A Preferred Stock and \$10.6 million of new investments. In October 2017, we exercised our contractual right to call for the redemption of the Series A Preferred Stock and all related outstanding warrants and paid an aggregate of approximately \$22.2 million.

In January 2012, we began publicly offering up to \$250.0 million in debt securities (initially named “Renewable Secured Debentures” and subsequently renamed “L Bonds”) that was completed in January 2015.

On September 24, 2014, we consummated an initial public offering of our common stock resulting in the sale of 800,000 shares of common stock at \$12.50 per share and net proceeds of approximately \$8.6 million after the deduction of underwriting commissions, discounts and expense reimbursements.

In January 2015, we began publicly offering up to \$1.0 billion of L Bonds as a follow-on to our earlier \$250.0 million public debt offering. In January 2018, we began publicly offering up to \$1.0 billion L Bonds as a follow-on to our earlier L Bond offering. Through March 31, 2018, the total amount of these L Bonds sold, including renewals, was \$900.6 million. As of March 31, 2018 and December 31, 2017, respectively, we had approximately \$483.8 million and \$461.4 million in principal amount of L Bonds outstanding.

In October 2015, we began publicly offering up to 100,000 shares of our Redeemable Preferred Stock (“RPS”) at a per-share price of \$1,000. As of December 31, 2017, we had issued approximately \$99.1 million stated value of RPS and terminated that offering.

In February 2017, we began publicly offering up to 150,000 shares of Series 2 Redeemable Preferred Stock (RPS 2) at a per-share price of \$1,000. As of March 31, 2018, we have issued approximately \$135.0 million stated value of RPS 2. Subsequent to March 31, 2018, we closed the RPS 2 offering to additional investors in April 2018.

The weighted-average interest rate of our outstanding L Bonds as of March 31, 2018 and December 31, 2017 was 7.24% and 7.29%, respectively, and the weighted-average maturity at those dates was 2.42 and 2.38 years, respectively. Our L Bonds have renewal features. Since we first issued our L Bonds, we have experienced \$416.8 million in maturities, of which \$247.1 million has renewed through March 31, 2018 for an additional term. This has provided us with an aggregate renewal rate of approximately 59.3% for investments in these securities.

Future contractual maturities of L Bonds at March 31, 2018 are:

| Years Ending December 31, | L Bonds |
|--------------------------------------|----------------|
| Nine months ending December 31, 2018 | \$ 80,988,000 |
| 2019 | 151,102,000 |
| 2020 | 93,940,000 |
| 2021 | 44,460,000 |
| 2022 | 39,938,000 |
| 2023 | 26,389,000 |
| Thereafter | 46,965,000 |
| | \$ 483,782,000 |

The principal amount of L Bonds outstanding will be significantly increased if we consummate the Exchange Transaction on the terms and conditions contemplated by the Master Agreement.

The L Bonds are secured by all of our assets and are subordinate to our senior credit facility with LNV Corporation.

On September 27, 2017, we entered into a \$300 million amended and restated senior credit facility with LNV Corporation in which DLP IV is the borrower. We intend to use the proceeds from this facility to grow and maintain our portfolio of life insurance policies, for liquidity and for general corporate purposes. As of March 31, 2018 we had approximately \$219.5 million outstanding under the senior credit facility with LNV Corporation.

We expect to meet our ongoing operational capital needs for policy acquisition, policy premiums and servicing costs, working capital and financing expenditures including paying principal, interest and dividends through a combination of the receipt of policy benefits from our portfolio of life insurance policies, net proceeds from our L Bond offering, and funding available from our senior credit facility with LNV Corporation. We estimate that our liquidity and capital resources are sufficient for our current and projected financial needs for at least the next twelve months given current assumptions. However, if we are unable to continue our offering for any reason (or if we become unsuccessful in selling our securities), and we are unable to obtain capital from other sources, our business will be materially and adversely affected. In addition, our business will be materially and adversely affected if we do not receive the policy benefits we forecast and if holders of our L Bonds fail to renew with the frequency we have historically experienced. In such a case, we could be forced to sell our investments in life insurance policies to service or satisfy our debt-related and other obligations. A sale under such circumstances may result in significant impairment of the recognized value of our portfolio.

Capital expenditures have historically not been material and we do not anticipate making material capital expenditures in 2018 or beyond.

Debt Financings Summary

The table below reconciles the face amount of our outstanding debt to the carrying value shown on our balance sheet:

| | As of March 31, 2018 | As of December 31, 2017 |
|---|----------------------|-------------------------|
| Total senior facility with LNV Corporation and other indebtedness | | |
| Face amount outstanding | \$ 219,470,000 | \$ 222,525,000 |
| Unamortized selling costs | (10,022,000) | (10,287,000) |
| Carrying amount | \$ 209,448,000 | \$ 212,238,000 |
| L Bonds: | | |
| Face amount outstanding | \$ 483,782,000 | \$ 461,427,000 |
| Subscriptions in process | 2,162,000 | 1,560,000 |

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| | | |
|---|------------------|------------------|
| Unamortized selling costs | \$ (16,214,000) | \$ (15,593,000) |
| Carrying amount | \$ 469,730,000 | \$ 447,394,000 |
| Portfolio Assets and Secured Indebtedness | | |

At March 31, 2018, the fair value of our investments in life insurance policies of \$687.4 million plus our cash balance of \$141.2 million and our restricted cash balance of \$16.6 million, plus matured policy benefits receivable

of \$12.3 million, totaled \$857.5 million, representing an excess of portfolio assets over secured indebtedness of \$154.2 million. At December 31, 2017, the fair value of our investments in life insurance policies of \$650.5 million plus our cash balance of \$114.4 million and our restricted cash balance of \$28.3 million, plus matured policy benefits receivable of \$16.7 million, totaled \$809.9 million, representing an excess of portfolio assets over secured indebtedness of \$126.0 million.

The following forward-looking table seeks to illustrate the impact that a hypothetical sale of our portfolio of life insurance assets at various discount rates would have on our ability to satisfy our debt obligations as of March 31, 2018. In all cases, the sale of the life insurance assets owned by DLP IV will be used first to satisfy all amounts owing under the respective senior credit facility with LNV Corporation. The net sale proceeds remaining after satisfying all obligations under the senior credit facility with LNV Corporation would be applied to L Bonds on a pari passu basis.

| Portfolio Discount Rate | 10% | 11% | 12% | 13% | 14% | 15% | 16% | 17% |
|---|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Value of portfolio | \$702,516,000 | \$669,661,000 | \$639,415,000 | \$611,504,000 | \$585,690,000 | \$561,765,000 | \$539,545,000 | \$518,860,000 |
| Cash, cash equivalents and policy benefits receivable | 170,068,000 | 170,068,000 | 170,068,000 | 170,068,000 | 170,068,000 | 170,068,000 | 170,068,000 | 170,068,000 |
| Total assets | 872,584,000 | 839,729,000 | 809,483,000 | 781,572,000 | 755,758,000 | 731,833,000 | 709,613,000 | 688,928,000 |
| Senior credit facility | 219,470,000 | 219,470,000 | 219,470,000 | 219,470,000 | 219,470,000 | 219,470,000 | 219,470,000 | 219,470,000 |
| Net after senior credit facility | 653,114,000 | 620,259,000 | 590,013,000 | 562,102,000 | 536,288,000 | 512,363,000 | 490,143,000 | 469,458,000 |
| L Bonds | 483,782,000 | 483,782,000 | 483,782,000 | 483,782,000 | 483,782,000 | 483,782,000 | 483,782,000 | 483,782,000 |
| Net after L Bonds | 169,332,000 | 136,477,000 | 106,231,000 | 78,320,000 | 52,506,000 | 28,581,000 | 6,361,000 | (14,310,000) |
| Impairment to L Bonds | No impairment | No impairment | No impairment | No impairment | No impairment | No impairment | No impairment | Impairment |

The table illustrates that our ability to fully satisfy amounts owing under the L Bonds would likely be impaired upon the sale of all our life insurance assets at a price equivalent to a discount rate of approximately 16.30% or higher. At December 31, 2017, the likely impairment occurred at a discount rate of approximately 15.04% or higher. The discount rates used to calculate the fair value of our portfolio were 10.45% as of both March 31, 2018 and December 31, 2017.

The table does not include any allowance for transactional fees and expenses associated with a portfolio sale (which expenses and fees could be substantial) and is provided to demonstrate how various discount rates used to value our portfolio could affect our ability to satisfy amounts owing under our debt obligations in light of our senior secured lender's right to priority payments. This table also does not include the yield maintenance fee, which could be substantial, we are required to pay in certain circumstances under our senior credit facility with LNV Corporation. You should read the above table in conjunction with the information contained in other sections of this report, including our discussion of discount rates included under the "Critical Accounting Policies — Fair Value Components — Discount Rate" caption above.

Amendment of Credit Facility

Effective September 27, 2017, DLP IV entered into an Amended and Restated Loan and Security Agreement with LNV Corporation, as lender, and CLMG Corp., as the administrative agent on behalf of the lenders under the agreement. The Loan and Security Agreement makes available a total of up to \$300,000,000 in credit to DLP IV with a maturity date of September 27, 2029. Additional advances are available under the Amended and Restated Loan Agreement at the LIBOR rate as defined in the Amended and Restated Loan Agreement. Advances are available as the result of additional borrowing base capacity, created as the premiums and servicing costs of pledged life insurance policies become due and by additional policy pledges to the facility or not. Interest will accrue on amounts borrowed under the Amended and Restated Loan Agreement at an annual interest rate, determined as of each date of borrowing or quarterly if there is no borrowing, equal to (A) the greater of 12-month LIBOR or the federal funds rate (as defined in the agreement) plus one-half of one percent per annum, plus (B) 7.50% per annum. The effective rate at March 31, 2018 was 9.63%. Interest payments are made on a quarterly basis.

Under the Amended and Restated Loan and Security Agreement, DLP IV has granted the administrative agent, for the benefit of the lenders under the agreement, a security interest in all of DLP IV's assets. As with prior collateral arrangements relating to the senior secured debt of GWG Holdings and its subsidiaries (on a consolidated basis), GWG Holdings' equity ownership in DLP IV continues to serve as collateral for the obligations of GWG Holdings under the L Bonds (although the life insurance assets owned by DLP IV will not themselves serve directly as collateral for those obligations).

Cash Flows

The payment of premiums and servicing costs to maintain life insurance policies represents our most significant requirement for cash disbursement. When a policy is purchased, we are able to calculate the minimum premium payments required to maintain the policy in-force. Over time as the insured ages, premium payments will increase. Nevertheless, the probability we will actually be required to pay the premiums decreases as mortality becomes more likely. These scheduled premiums and associated probabilities are factored into our expected internal rate of return and cash-flow modeling. Beyond premiums, we incur policy servicing costs, including annual trustee, policy administration and tracking costs. Additionally, we incur financing costs, including principal, interest and dividends. Both policy servicing costs and financing costs are excluded from our internal rate of return calculations. Until we receive a sufficient amount of proceeds from the policy benefits, we intend to pay these costs from our senior credit facility with LNV Corporation, when permitted, and through the issuance of L Bonds.

The amount of payments for anticipated premiums, including the requirement by our senior credit facility with LNV Corporation to maintain a two month cost-of-insurance threshold within each policy cash value account, and servicing costs that we will be required to make over the next five years to maintain our current portfolio, assuming no mortalities, is set forth in the table below.

| Years Ending December 31, | Premiums | Servicing | Premiums and Servicing Fees |
|--------------------------------------|----------------|-----------|-----------------------------|
| Nine months ending December 31, 2018 | \$ 41,177,000 | 995,000 | 42,172,000 |
| 2019 | 61,480,000 | 1,327,000 | 62,807,000 |
| 2020 | 70,661,000 | 1,327,000 | 71,988,000 |
| 2021 | 80,949,000 | 1,327,000 | 82,276,000 |
| 2022 | 92,191,000 | 1,327,000 | 93,518,000 |
| 2023 | 102,177,000 | 1,327,000 | 103,504,000 |
| | \$ 448,635,000 | 7,630,000 | 456,265,000 |

Our anticipated premium expenses are subject to the risk of increased cost-of-insurance charges (i.e., “COI” or premium charges) for the life insurance policies we own. In August 2017, Phoenix Life Insurance Company notified us of pending cost-of-insurance rate increases for certain life insurance policies in our portfolio that will be effective on the policy anniversary dates after November 2017. We identified two affected policies in our portfolio and completed our analysis and incorporation for the revision to our expected premium charges for these two policies as of March 31, 2018. We recently received notice of one additional pending cost-of-insurance increase affecting one other policy in our portfolio. As a result, we expect that our premium expense will increase and the fair value of the policy and our portfolio will be negatively impacted once the insurer has specified and implemented, and we have analyzed and incorporated, the proposed increases. On May 9, 2018 we learned that John Hancock Life Insurance Company (“John Hancock”) has begun sending notices of cost-of-insurance increases on Performance UL policies issued between 2003 and 2010. We currently hold 15 of such issued policies representing a total of \$49,500,000 in policy benefits and accounting for 3.7% of the fair value of our portfolio as of March 31, 2018. We have not received any notices from John Hancock and will continue to monitor carrier communications to identify affected policies for further analysis. Except as noted above, we have no pending cost-of-insurance increases on any other policies in our portfolio, but we are aware that cost-of-insurance increases have become more prevalent in the industry. Thus, we may see additional insurers implementing cost-of-insurance increases in the future.

For the quarter-end dates set forth below, the following table illustrates the total amount of face value of policy benefits owned, and the trailing 12 months of life insurance policy benefits realized and premiums paid on our portfolio. The trailing 12-month benefits/premium coverage ratio indicates the ratio of policy benefits realized to premiums paid over the trailing 12-month period from our portfolio of life insurance policies.

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| Quarter End Date | Portfolio Face Amount (\$) | 12-Month Trailing Benefits Realized (\$) | 12-Month Trailing Premiums Paid (\$) | 12-Month Trailing Benefits/Premium Coverage Ratio |
|--------------------|----------------------------|--|--------------------------------------|---|
| March 31, 2015 | 754,942,000 | 46,675,000 | 23,786,000 | 196.2 % |
| June 30, 2015 | 806,274,000 | 47,125,000 | 24,348,000 | 193.5 % |
| September 30, 2015 | 878,882,000 | 44,482,000 | 25,313,000 | 175.7 % |
| December 31, 2015 | 944,844,000 | 31,232,000 | 26,650,000 | 117.2 % |
| March 31, 2016 | 1,027,821,000 | 21,845,000 | 28,771,000 | 75.9 % |
| June 30, 2016 | 1,154,798,000 | 30,924,000 | 31,891,000 | 97.0 % |
| September 30, 2016 | 1,272,078,000 | 35,867,000 | 37,055,000 | 96.8 % |
| December 31, 2016 | 1,361,675,000 | 48,452,000 | 40,239,000 | 120.4 % |
| March 31, 2017 | 1,447,558,000 | 48,189,000 | 42,753,000 | 112.7 % |
| June 30, 2017 | 1,525,363,000 | 49,295,000 | 45,414,000 | 108.5 % |
| September 30, 2017 | 1,622,627,000 | 53,742,000 | 46,559,000 | 115.4 % |
| December 31, 2017 | 1,676,148,000 | 64,719,000 | 52,263,000 | 123.8 % |
| March 31, 2018 | 1,758,066,000 | 60,248,000 | 53,169,000 | 113.3 % |

We believe that the portfolio cash flow results set forth above are consistent with our general investment thesis: that the life insurance policy benefits we receive will continue to increase over time in relation to the premiums we are required to pay on the remaining policies in the portfolio. Nevertheless, we expect that our portfolio cash flow on a period-to-period basis will remain inconsistent until such time as we achieve our goal of acquiring a larger, more diversified portfolio of life insurance policies.

Inflation

Changes in inflation do not necessarily correlate with changes in interest rates. We presently do not foresee any material impact of inflation on our results of operations in the periods presented in our condensed consolidated financial statements.

Off-Balance Sheet Arrangements

We are party to an office lease with U.S. Bank National Association as the landlord. On September 1, 2015, we entered into an amendment that expanded the leased space to 17,687 square feet and extended the term through October 2025 (see Note 17 to the condensed consolidated financial statements).

Credit Risk

We review the credit risk associated with our portfolio of life insurance policies when estimating its fair value. In evaluating the policies' credit risk, we consider insurance company solvency, credit risk indicators, economic conditions, ongoing credit evaluations, and company positions. We attempt to manage our credit risk related to life insurance policies typically by purchasing policies issued only from companies with an investment-grade credit rating by either Standard & Poor's, Moody's, or A.M. Best Company. As of March 31, 2018, 96.6% of our life insurance policies, by face value benefits, were issued by companies that maintained an investment-grade rating (BBB or better) by Standard & Poor's.

Interest Rate Risk

Our senior credit facility with LNV Corporation is floating-rate financing. In addition, our ability to offer interest and dividend rates that attract capital (including in our continuous offering of L Bonds) is generally impacted by prevailing interest rates. Furthermore, while our L Bond offering provides us with fixed-rate debt financing, our Debt

Coverage Ratio is calculated in relation to the interest rate on all of our debt financing. Therefore, fluctuations in interest rates impact our business by increasing our borrowing costs and reducing availability under our debt financing arrangements. We calculate our portfolio earnings based upon the spread generated between the return on our life insurance portfolio and the total cost of our financing. As a result, increases in interest rates will reduce the earnings we expect to achieve from our investments in life insurance policies.

Non-GAAP Financial Measures

Non-GAAP financial measures disclosed by our management are provided as additional information to investors in order to provide an alternative method for assessing our financial condition and operating results. These non-GAAP financial measures are not in accordance with GAAP and may be different from non-GAAP measures used by other companies, including other companies within our industry. This presentation of non-GAAP financial information is not meant to be considered in isolation or as a substitute for comparable amounts prepared in accordance with GAAP. See our condensed consolidated financial statements and our financial statements contained herein.

We use non-GAAP financial measures for management's assessment of our financial condition and operating results without regard to GAAP fair value standards. The application of current GAAP fair value standards, especially during a period of significant growth of our portfolio and our Company may result in current period GAAP financial results that may not be reflective of our long-term earnings potential or overall financial condition. Management believes that our non-GAAP financial measures permit investors to understand long-term earnings performance without regard to the volatility in GAAP financial results that can, and does, occur during this stage of our portfolio and company growth.

Therefore, in contrast to a GAAP fair valuation, we seek to measure the accrual of the actuarial gain occurring within the portfolio of life insurance policies at our expected internal rate of return (exclusive of future interest costs) based on statistical mortality probabilities for the insureds (using primarily the insured's age, sex, health and smoking status). The expected internal rate of return tracks actuarial gain occurring within the policies according to a mortality table as the insureds' age increases. By comparing the actuarial gain accruing within our portfolio of life insurance policies against our adjusted operating costs during the same period, we can estimate the overall financial performance of our business without regard to fair value volatility. We use this information to balance our life insurance policy purchasing and manage our capital structure, including the issuance of debt and utilization of our other sources of capital, and to monitor our compliance with borrowing covenants. We believe that these non-GAAP financial measures provide information that is useful for investors to understand period-over-period operating results separate and apart from fair value items that can have a disproportionately positive or negative impact on GAAP results in any particular reporting period.

In addition, the Indenture governing our L Bonds requires us to maintain a "Debt Coverage Ratio" designed to provide reasonable assurance that the buy and hold value of our life insurance portfolio plus the value of all our other assets exceed our total outstanding indebtedness. This ratio is calculated using non-GAAP measures in the method described below, again without regard to GAAP-based fair value measures.

| | As of March 31, 2018 | As of December 31, 2017 |
|---|----------------------------|----------------------------|
| Non-GAAP Investment Cost Basis | | |
| GAAP investment in life insurance policies, at fair value | \$ 687,389,000 | \$ 650,527,000 |
| Unrealized fair value gain(1) | (348,032,000) | (331,386,000) |
| Adjusted cost basis increase(2) | 345,673,000 | 325,100,000 |
| Non-GAAP investment cost basis(3) | \$ 685,030,000 | \$ 644,241,000 |

-
- (1) This represents the reversal of cumulative unrealized GAAP fair value gain of life insurance policies.
- (2) Adjusted cost basis is increased to interest, premiums and servicing fees that are expensed under GAAP.
- (3) This is the non-GAAP investment cost basis in life insurance policies from which our expected internal rate of return is calculated.

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Excess Spread. Management uses the “total excess spread” to gauge expected profitability of our investments. The Expected IRR of our portfolio is based upon future cash flow forecasts derived from a probabilistic analysis of our policy benefits received and policy premiums paid in relation to our non-GAAP investment cost basis.

| | As of March 31, 2018 | % | As of December 31, 2017 | % |
|--|----------------------------|---|----------------------------|---|
| Expected IRR(1) | 10.35 | % | 10.48 | % |
| Total weighted-average interest rate on indebtedness for borrowed money(2) | 7.99 | % | 7.95 | % |
| Total excess spread(3) | 2.36 | % | 2.53 | % |

(1) Excludes IRR realized on matured life insurance policies — which are substantial.

(2) Represents the weighted-average interest rate paid on all interest-bearing indebtedness as of the measurement date, determined as follows:

| Indebtedness | As of March 31, 2018 | As of December 31, 2017 |
|---|----------------------------|----------------------------|
| Senior credit facility with LNV Corporation | \$ 219,470,000 | \$ 222,525,000 |
| L Bonds | 483,782,000 | 461,427,000 |
| Total | \$ 703,252,000 | \$ 683,952,000 |

Interest Rates on Indebtedness

| | | | | |
|--|------|---|------|---|
| Senior credit facility with LNV Corporation | 9.63 | % | 9.31 | % |
| L Bonds | 7.24 | % | 7.29 | % |
| Weighted-average interest rates paid on indebtedness | 7.99 | % | 7.95 | % |

(3) Calculated as the Expected IRR minus the weighted-average interest rate on interest-bearing indebtedness(2).

Adjusted Non-GAAP Net Income. We calculate our adjusted non-GAAP net income by recognizing the actuarial gain accruing within our life insurance portfolio at the Expected IRR against our adjusted cost basis without regard to fair value. We net this actuarial gain against our adjusted operating costs during the same period to calculate our net income on a non-GAAP basis.

| | Three Months Ended March 31, 2018 | 2017 |
|--|--------------------------------------|-----------------|
| GAAP net (loss) attributable to common shareholders | \$ (12,883,000) | \$ (1,913,000) |
| Unrealized fair value gain(1) | (16,645,000) | (13,884,000) |
| Adjusted cost basis increase(2) | 25,997,000 | 21,722,000 |
| Accrual of unrealized actuarial gain(3) | 6,601,000 | 4,910,000 |
| Total adjusted non-GAAP net income attributable to common shareholders | \$ 3,070,000 | \$ 10,835,000 |

(1) Reversal of unrealized GAAP fair value gain on life insurance policies for current period.

(2) Adjusted cost basis is increased to include interest, premiums and servicing fees that are expensed under GAAP.

(3) Accrual of actuarial gain at Expected IRR.

Adjusted Non-GAAP Tangible Net Worth. We calculate our adjusted non-GAAP tangible net worth by recognizing the actuarial gain accruing within our life insurance policies at the Expected IRR of the policies we own without regard to fair value. We net this actuarial gain against our costs during the same period to calculate our adjusted tangible net worth on a non-GAAP basis.

| | As of March 31, 2018 | As of December 31, 2017 |
|---------------------------|----------------------------|----------------------------|
| GAAP net worth | \$ 163,747,000 | \$ 133,672,000 |
| Less intangible assets(1) | (30,662,000) | (30,354,000) |

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| | | |
|--|----------------|----------------|
| GAAP tangible net worth | 133,085,000 | 103,318,000 |
| Unrealized fair value gain(2) | (348,032,000) | (331,386,000) |
| Adjusted cost basis increase(3) | 345,673,000 | 325,100,000 |
| Accrual of unrealized actuarial gain(4) | 164,844,000 | 158,241,000 |
| Total adjusted non-GAAP tangible net worth | \$ 295,570,000 | \$ 255,273,000 |

-
- (1) Unamortized portion of deferred financing costs and pre-paid insurance.
 - (2) Reversal of cumulative unrealized GAAP fair value gain or loss of life insurance policies.
 - (3) Adjusted cost basis is increased to include interest, premiums and servicing fees that are expensed under GAAP.
 - (4) Accrual of cumulative actuarial gain at Expected IRR.

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Debt Coverage Ratio. Our L Bonds borrowing covenants require us to maintain a Debt Coverage Ratio of less than 90%. The Debt Coverage Ratio is calculated by dividing the sum of our total interest-bearing indebtedness by the sum of our cash, cash equivalents, and policy benefits receivable by the net present value of the life insurance portfolio, and, without duplication, the value of all of our other assets as reflected on our most recently available balance sheet prepared in accordance with GAAP.

| | As of March 31, 2018 | | As of December 31, 2017 | |
|---|----------------------------|------|-------------------------------|------|
| Life insurance portfolio policy benefits | \$ 1,758,066,000 | | \$ 1,676,148,000 | |
| Discount rate of future cash flows (1) | 7.99 | %(1) | 7.95 | %(1) |
| Net present value of life insurance portfolio policy benefits | \$ 777,753,000 | | \$ 737,625,000 | |
| Cash and cash equivalents | 157,765,000 | | 142,771,000 | |
| Life insurance policy benefits receivable | 12,303,000 | | 16,659,000 | |
| Total Coverage | \$ 947,821,000 | | \$ 897,055,000 | |
| Senior credit facility | \$ 219,470,000 | | \$ 222,525,000 | |
| L Bonds | 483,782,000 | | 461,427,000 | |
| Total Indebtedness | \$ 703,252,000 | | \$ 683,952,000 | |
| Debt Coverage Ratio | 74.20 | % | 76.24 | % |

(1) Weighted-average interest rate paid on indebtedness.

As of March 31, 2018 and December 31, 2017, we were in compliance with the Debt Coverage Ratio.

Expected Portfolio Internal Rate of Return at Purchase. Expected portfolio IRR at purchase is calculated as the weighted average (by face amount of policy benefits) derived from a probabilistic analysis of policy benefits received and policy premiums paid relative to our purchase price for all life insurance policies in the portfolio. This non-GAAP measure isolates our IRR expectation at purchase utilizing our underwriting life expectancy assumptions at the time of purchase. This measure does not change with the passage of time as compared to our non-GAAP investment cost basis that increases with the payment of premiums, financing costs, and the effective life expectancy which changes over time, both of which are used to calculate our Expected IRR.

| | As of March 31, 2018 | | As of December 31, 2017 | |
|---|----------------------------|---|----------------------------|---|
| Life insurance portfolio policy benefits | \$ 1,758,066,000 | | \$ 1,676,148,000 | |
| Total number of policies | 942 | | 898 | |
| Non-GAAP Expected Portfolio Internal Rate of Return at Purchase | 15.25 | % | 15.32 | % |

40

Portfolio Information

Our portfolio of life insurance policies, owned by our subsidiaries as of March 31, 2018, is summarized below:

Life Insurance Portfolio Summary

| | | |
|---|------------------|---|
| Total portfolio face value of policy benefits | \$ 1,758,066,000 | |
| Average face value per policy | \$ 1,866,000 | |
| Average face value per insured life | \$ 2,088,000 | |
| Average age of insured (yrs.)* | 81.9 | |
| Average life expectancy estimate (yrs.)* | 6.9 | |
| Total number of policies | 942 | |
| Number of unique lives | 842 | |
| Demographics | 75% Males; | |
| | 25% Females | |
| Number of smokers | 37 | |
| Largest policy as % of total portfolio | 0.75 | % |
| Average policy as % of total portfolio | 0.11 | % |
| Average annual premium as % of face value | 2.88 | % |

* Averages presented in the table are weighted averages.

Our portfolio of life insurance policies, owned by our wholly owned subsidiaries as of March 31, 2018, organized by the insured's current age and the associated number of policies and policy benefits, is summarized below:

Distribution of Policies and Policy Benefits by Current Age of Insured

| Min Age | Max Age | Number of Policies | Policy Benefits | Wtd. Avg. LE (yrs.) | Percentage of Total Number of Policies | | Policy Benefits | |
|---------|---------|--------------------|-----------------|---------------------|--|---|-----------------|---|
| 95 | 100 | 11 | 16,154,000 | 1.3 | 1.2 | % | 0.9 | % |
| 90 | 94 | 102 | 194,996,000 | 2.8 | 10.8 | % | 11.1 | % |
| 85 | 89 | 203 | 440,490,000 | 4.9 | 21.6 | % | 25.1 | % |
| 80 | 84 | 206 | 447,747,000 | 6.6 | 21.9 | % | 25.5 | % |
| 75 | 79 | 181 | 320,696,000 | 8.9 | 19.2 | % | 18.2 | % |
| 70 | 74 | 167 | 258,110,000 | 10.7 | 17.7 | % | 14.7 | % |
| 60 | 69 | 72 | 79,873,000 | 9.6 | 7.6 | % | 4.5 | % |
| Total | | 942 | 1,758,066,000 | 6.9 | 100.0 | % | 100.0 | % |

Our portfolio of life insurance policies, owned by our subsidiaries as of March 31, 2018, organized by the insured's estimated life expectancy and associated policy benefits, is summarized below:

Distribution of Policies by Current Life Expectancies (LE) of Insured

| Min LE (Months) | Max LE (Months) | Number of Policies | Policy Benefits | Percentage of Total Number of Policies | | Policy Benefits | |
|-----------------|-----------------|--------------------|-----------------|--|---|-----------------|---|
| 1 | 47 | 248 | 406,012,000 | 26.3 | % | 23.1 | % |
| 48 | 71 | 192 | 351,218,000 | 20.4 | % | 20.0 | % |
| 72 | 95 | 192 | 387,652,000 | 20.4 | % | 22.0 | % |
| 96 | 119 | 150 | 298,579,000 | 15.9 | % | 17.0 | % |

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| | | | | | | | |
|-------|-----|-----|---------------|-------|---|----------|---|
| 120 | 143 | 85 | 145,376,000 | 9.0 | % | 8.3 | % |
| 144 | 179 | 64 | 124,882,000 | 6.8 | % | 7.1 | % |
| 180 | 206 | 11 | 44,347,000 | 1.2 | % | 2.5 | % |
| Total | | 942 | 1,758,066,000 | 100.0 | % | \$ 100.0 | % |
| 41 | | | | | | | |

We track concentrations of pre-existing medical conditions among insured individuals within our portfolio based on information contained in life expectancy reports including the underwriter's designation of primary impairment. We track these medical conditions within the following ten primary categories: (1) cancer, (2) cardiovascular, (3) cerebrovascular, (4) dementia, (5) diabetes, (6) multiple conditions, (7) neurological disorders, (8) respiratory disease, (9) other, and (10) no diseases. Currently, the primary disease categories within our portfolio that represent a concentration of over 10% are multiple conditions, cardiovascular, and other which constitute 25.9%, 21.4%, and 13.0%, respectively, of the face amount of insured benefits of our portfolio as of March 31, 2018.

The yield to maturity on bonds issued by life insurance carriers reflects, among other things, the credit risk (risk of default) of such insurance carrier. We follow the yields on certain publicly traded life insurance company bonds because this information is part of the data we consider when valuing our portfolio of life insurance policies for our financial statements.

The average yield to maturity of publicly traded life insurance company bonds data we consider when valuing our portfolio of life insurance policies was 3.80% as of March 31, 2018. We believe that this reflects, in part, the financial market's judgment that credit risk is low with regard to these carriers' financial obligations. It should be noted that the obligations of life insurance carriers to pay life insurance policy benefits ranks senior to all of their other financial obligations, such as the aforementioned senior bonds they issue.

As of March 31, 2018, approximately 96.6% of the face value of policy benefits in our life insurance portfolio were issued by insurance companies with investment-grade credit ratings from Standard & Poor's. Our ten largest life insurance company credit exposures and the Standard & Poor's credit rating of their respective financial strength and claims-paying ability is set forth below:

Distribution of Policy Benefits by Top 10 Insurance Companies

| Rank | Policy Benefits | Percentage of Policy Benefit Amount | Insurance Company | Ins. Co. S&P Rating |
|------|-----------------|-------------------------------------|--|---------------------|
| 1 | \$ 265,932,000 | 15.1 % | John Hancock Life Insurance Company (U.S.A.) | AA- |
| 2 | \$ 203,006,000 | 11.5 % | AXA Equitable Life Insurance Company | A+ |
| 3 | \$ 194,565,000 | 11.1 % | Lincoln National Life Insurance Company | AA- |
| 4 | \$ 167,753,000 | 9.5 % | Transamerica Life Insurance Company | AA- |
| 5 | \$ 118,822,000 | 6.8 % | Metropolitan Life Insurance Company | AA- |
| 6 | \$ 89,303,000 | 5.1 % | American General Life Insurance Company | A+ |
| 7 | \$ 62,992,000 | 3.6 % | Pacific Life Insurance Company | AA- |
| | | | Massachusetts Mutual Life Insurance Company | AA+ |
| 8 | \$ 57,743,000 | 3.3 % | Reliastar Life Insurance Company | A |
| 9 | \$ 54,803,000 | 3.1 % | Security Life of Denver Insurance Company | A |
| 10 | \$ 53,202,000 | 3.0 % | | |
| | 1,268,121,000 | 72.1 % | | |

Secondary Life Insurance — Portfolio Return Modeling

The goal of our portfolio of life insurance assets is to earn superior risk-adjusted returns. At any time, we calculate our returns from our life insurance assets based upon (i) our historical results; and (ii) the future cash flows we expect to realize from our statistical forecasts. To forecast our expected future cash flows and returns, we use the probabilistic method of analysis. The expected internal rate of return of our portfolio is based upon future cash flow forecasts derived from a probabilistic analysis of policy benefits received and policy premiums paid in relation to our non-GAAP investment cost basis. As of March 31, 2018, the expected internal rate of return on our portfolio of life insurance assets was 10.35% based on our portfolio benefits of \$1.76 billion and our non-GAAP investment cost basis

of \$685 million (including purchase price, premiums paid, and financing costs incurred to date). This calculation excludes returns realized from our matured policy benefits which are substantial.

We seek to further enhance our understanding of our expected future cash flow and returns by using a stochastic analysis, sometimes referred to as a “Monte Carlo simulation,” to provide us with a greater understanding of the variability of our projections. The stochastic analysis we perform provides internal rates of return calculations for different statistical confidence intervals. The results of our stochastic analysis, in which we run 10,000 random

mortality scenarios, demonstrates that the scenario ranking at the 50th percentile of all 10,000 results generates an internal rate of return (“IRR”) of 10.31%, which is very near to our expected IRR (“Expected IRR”) of our portfolio of 10.35%. Our Expected IRR is based upon future cash flow forecasts derived from a probabilistic analysis of our policy benefits received and policy premiums paid in relation to our non-GAAP investment cost basis. The stochastic analysis results also indicate that our portfolio is expected under this hypothetical analysis to generate an internal rate of return of 9.85% or better in 75% of all generated scenarios; and an internal rate of return of 9.44% or better in 90% of all generated scenarios. As the portfolio continues to grow in size and diversity, all else equal, the hypothetical scenario results cluster closer to each other around our median, or 50th percentile, internal rate of return expectation, thereby lowering future cash flow volatility and potentially justifying our use of lower discount rates to value our portfolio as size and diversification continue to increase over time.

In sum, we believe our statistical analyses show that, if we can continue to grow and maintain our investments in life insurance assets, then, in the absence of material negative events affecting our most significant risks, including but not limited to longevity, credit risk, interest rate and financing risk, those investments will potentially provide superior risk-adjusted returns for our Company.

The complete detail of our portfolio of life insurance policies, owned by our wholly owned subsidiaries as of March 31, 2018, organized by the current age of the insured and the associated policy benefits, sex, estimated life expectancy, issuing insurance carrier, and the credit rating of the issuing insurance carrier, is set in Exhibit 99.2 to this report.

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in our reports filed pursuant to the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance the objectives of the control system are met.

As of March 31, 2018, our Chief Executive Officer and Chief Financial Officer carried out an evaluation of the effectiveness of our disclosure controls and procedures as such term is defined in Rule 13a-15(e) under the Securities and Exchange Act of 1934, as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with management’s evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Securities Exchange Act of 1934 during the period covered by this report that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management’s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable

detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only with proper authorizations; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management, under the supervision of and with the participation of the Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of our internal control over financial reporting as of March 31, 2018 based on criteria for effective control over financial reporting set forth by the Committee of Sponsoring Organizations of the Treadway Commission, 2013 framework in “Internal Control — Integrated Framework.” Based on this assessment, our management concluded that, as of the evaluation date, we maintained effective internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 6. EXHIBITS

Exhibit

- 10.7 Amended and Restated Master Exchange Agreement, dated January 18, 2018 (filed herewith).
- 10.8 First Amendment to Master Exchange Agreement, dated April 30, 2018 (filed herewith).
- 31.1 Section 302 Certification of the Chief Executive Officer (filed herewith).
- 31.2 Section 302 Certification of the Chief Financial Officer (filed herewith).
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 99.1 Letter from Model Actuarial Pricing Systems, dated April 23, 2018 (filed herewith).
- 99.2 Portfolio of Life Insurance Policies as of March 31, 2018 (filed herewith).
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

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

GWG HOLDINGS, INC.

Date: May 11, 2018

By:

/s/ Jon R. Sabes
Chief Executive Officer

Date: May 11, 2018

By:

/s/ William B. Acheson
Chief Financial Officer

EXHIBIT INDEX

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