



# Cultivating Growth

Westwood Holdings Group, Inc. 2006 Annual Report

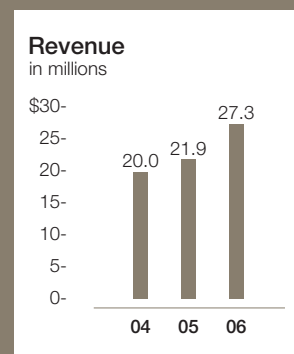
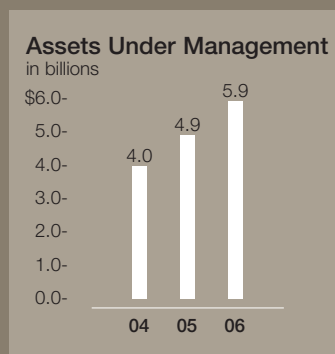


# Financial Highlights

In thousands, except per share data	Years ended December 31,		
	2006	2005	2004
<b>Operating Results</b>			
Revenues	\$27,364	\$21,940	\$19,980
Income before income taxes	7,254	6,043	5,985
Net income	4,508	3,636	3,686
Earnings per share – diluted	\$ 0.79	\$ 0.66	\$ 0.68
<b>Balance Sheet Data</b>			
Cash and investments	\$20,110	\$19,775	\$19,352
Total assets	28,722	27,310	26,277
Stockholders' equity	22,735	21,559	21,663
Dividends declared	8,740	6,488	5,682
<b>Assets under management (\$ millions)</b>	<b>\$ 5,927</b>	<b>\$ 4,928</b>	<b>\$ 3,996</b>

## Forward-Looking Statements

This Annual Report to Stockholders contains some forward-looking statements within the meaning of the federal securities laws. Actual results and the timing of some events could differ materially from those projected in or contemplated by the forward-looking statements due to a number of factors, including without limitation those set forth under the "Forward-Looking Statements" and "Risk Factors" sections in the Annual Report on Form 10-K included herein.



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# Growing With Hard Work, Discipline and Integrity



**A**t Westwood Holdings Group, we are focused on creating opportunities for long-term growth and delivering superior results for our clients, our stockholders and our employees. Since we became a public company in July 2002, we have created a diverse family of products, expanded our distribution capabilities and built a talented team of professionals. Even as we built the foundation for growth, we continued to deliver superior results for our clients and stockholders. We are proud of the progress we have made and excited by the growth opportunities we are now ready to pursue.

In this year's annual report, you can read about our strategies to take our product performance to the marketplace. In every market, our strategies leverage our key strengths at Westwood – a proven, disciplined investment approach, a dedication to excellent client service, and the experience of our exceptional employees. Going forward, we will continue on our mission to cultivate growth for all our stakeholders and we will do it in the only way we know how – with hard work, discipline and absolute integrity.

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## About Westwood

Westwood Holdings Group, Inc. manages investment assets and provides services for its clients through two subsidiaries, Westwood Management Corp. and Westwood Trust. Westwood Management Corp. is a registered investment advisor and provides investment advisory services to corporate pension funds, public retirement plans, endowments, foundations, the WHG Funds, other mutual funds and clients of Westwood Trust. Westwood Trust provides, to institutions and high net worth individuals, trust and custodial services and participation in common trust funds that it sponsors. Westwood Holdings Group, Inc. trades on the New York Stock Exchange under the symbol "WHG." For more information, please visit the Company's website at [www.westwoodgroup.com](http://www.westwoodgroup.com). You may obtain information about the WHG Funds by visiting [www.whgfunds.com](http://www.whgfunds.com) or by calling (877) FUND-WHG.



# Letter

to Our Clients, Our Stockholders and Our Employees

In 2007, we will complete our fifth year as a public company. With the hard work of our talented employees and nearly 24 years of experience in delivering investment results to our clients, we have been able to make tremendous progress in our first five years as Westwood Holdings Group, Inc. We have built a diverse family of products with a solid track record of performance. We developed and are now successfully executing our distribution strategy by pursuing growth opportunities in three distinct markets. We have created a unique partnership between our employee stockholders and our outside stockholders and are now realizing the benefits of that partnership. The progress we have made in each of these areas is evident in our 2006 results and in the opportunities we see for Westwood in the years ahead.

## 2006 Financial Results

Our assets under management reached \$5.9 billion at year-end 2006, the highest level in our company's history. The increase in assets, up 20.3 percent over year-end 2005, was due to market appreciation of assets under management and inflows of assets from new clients, partially offset by the withdrawal of assets by certain clients. Revenues for 2006 were \$27.4 million versus \$21.9 million in 2005, an increase of 24.7 percent. Net income was \$4.5 million in 2006 or \$0.79 per diluted share versus \$3.6 million or \$0.66 per diluted share in 2005, an increase of 24.0 percent in net income and 19.7 percent in earnings per share.

Our strong improvement in cash earnings further demonstrates the underlying strength and cash-generation capability of our business. As a result, in July 2006, our Board of Directors approved an increase in our quarterly dividend payout from \$0.09 per share to \$0.15 per share and approved a special dividend of \$0.85 per share. Our dividend yield at year-end was 2.6 percent, which is well above the average of our asset management peer group. Including special dividends, our yield was 6.3 percent. Since the time we became a public company in 2002, we have returned \$27.6 million to our stockholders in the form of dividends. We continue to believe that the most advantageous business model is one that generates strong cash flows and has the ability to pay excess cash to stockholders. We follow that model in running our business and seek to invest in companies that do the same.

#### **A Diverse Family of Products and a Solid Performance Record**

In a year of solid performance, the majority of our products delivered results that ranked in the top quartile of their respective peer groups in 2006. In particular, our newer products – SMidCap Value, SmallCap Value and Income Opportunity – performed well ahead of their benchmarks. Our LargeCap Value and Balanced products completed a 20-year performance record, each placing in the top quartile of their respective peer groups for that time period.

Going forward, we intend to focus on taking our SmallCap Value product to the institutional market. At year-end 2006, SmallCap Value had reached the performance metrics that institutional clients typically require before investment – \$100 million in assets and a three-year track record of performance. The small cap asset class tends to be capacity-constrained, with a chronic shortage of small cap products open to new investors. As a result, we expect a positive reception for our SmallCap Value product. In addition, our AllCap Value product is striving to reach the institutional threshold for assets. We expect to introduce AllCap Value to institutional investors in the near future as well.

In all of our products, our investment philosophy is simple and consistent – to earn superior returns for our clients by controlling downside risk. We employ discipline and integrity always; never forgetting that the money we invest belongs to our clients.

#### **Distribution Highlights and Growth Opportunities**

With much of the hard work of building a diverse product family complete, we are now focused on taking our performance to market. We distribute our products to multiple target markets – the large institutional market via institutional investment consultants; small to mid-size institutions and high net worth individuals via Westwood Trust; and the institutional mutual fund market via the WHG Funds and other sub-advised mutual funds. We have participated in the institutional market and the high net worth market for many years and in 2005, we expanded our focus on the mutual fund marketplace.

We believe there are substantial opportunities to leverage our existing products and relationships in the \$10 trillion mutual fund market. Many of our institutional clients have

We continue to believe the most advantageous business model is one that generates strong cash flows and has the ability to pay excess cash to stockholders.

defined contribution plans in addition to defined benefit plans. By offering our WHG Funds to the 401(k) market, we feel we can leverage our existing client and consultant relationships, and extend our product line.

In 2006, we added significantly to our product offerings for the institutional mutual fund market. In addition to WHG SMidCap (WHGMX) and WHG Income Opportunity (WHGIX), which launched in late 2005, we launched WHG LargeCap Value (WHGLX) in July 2006 and WHG Balanced (WHGBX) in September 2006. We also lowered the minimum investment levels for the funds from \$100,000 to \$5,000 to broaden access to our institutional funds. All WHG Funds have capped expense ratios and are distributed by SEI Investments Distribution Co.



In just one year, our family of WHG Funds has already reached \$130 million in assets – evidence that the performance of our products is recognized and valued by clients in the mutual fund market.

We continue to focus a great deal of effort on the institutional market, which represents approximately 75 percent of the assets we currently have under management. We regularly market our products in meetings with institutional investment consultants and participate in a number of on-site reviews in our offices with our entire team. We work hard to maintain the strong relationships we have built over time with many consultants. We also continue to introduce our products, investment process and people to additional consulting firms to ensure we are well positioned as new client opportunities arise.

Westwood Trust continued its strong performance in 2006. Its assets under management grew to \$1.6 billion through the appreciation of assets under management and the acquisition of new clients, mostly through referrals. Through our Enhanced Balanced™ product, we continue to provide superior custom asset allocation solutions delivered with the attentive service our Westwood Trust clients demand and deserve.

#### **A Unique Partnership and Clear Advantage**

We use equity-based compensation to reward our employees and fully align employee interests with those of our stockholders. Through restricted stock grants, our employees hold more than 30 percent of our outstanding shares. We believe this creates a unique partnership between our internal and external stockholders that creates clear advantages for Westwood.

As our firm generates excess cash and pays it out as dividends, both our employee stockholders and external stockholders benefit. All our stakeholders – clients, employees and external stockholders – benefit from the growth and expanded capabilities of the company. We believe this relatively simple alignment toward a clear, common goal is a powerful force that can drive sustained positive results.

### Encouraging Signs Ahead

While we continue to do the hard work of delivering solid investment performance and expanding our distribution opportunities, we also monitor the major industry and economic trends that affect our results. Looking ahead to 2007 and beyond, we see several encouraging signs among the major trends. For example:

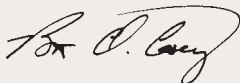
- The oldest of the baby boomers began retiring in recent years, highlighting their need to manage the accumulation and distribution of their assets. Westwood offers multiple solutions to meet these needs including Westwood Trust for high net worth individuals, WHG Funds for those invested in a 401(k) plan and our traditional institutional products for those in defined benefit plans.
- We expect to see higher returns on cash investments in the future than we have seen for many years. We believe that for the first time in a long time the markets will favor those companies that generate cash over those that borrow. That type of market plays to our strengths as a cash generator and to the strengths of the types of companies we prefer as investors.

We look forward to exploring the possibilities in 2007 and future years. We believe that we have the products, the investment process and, most importantly, the people to take advantage of future opportunities.

We close 2006 with a heart-felt thank you to our employees. Their hard work, dedication to excellence, and absolute integrity in the service of our clients is behind our strong performance over the past five years. We also thank our clients for their continued trust. We are committed to delivering the strong performance and attentive service you have come to expect from Westwood in the years ahead.

We are gratified by the progress we have made at Westwood in our first five years as a public company. We are excited and ready to act – for the benefit of our clients, stockholders and employees – on the opportunities we see ahead.

Our employees' hard work, dedication to excellence and absolute integrity in the service of our clients is behind our strong performance.



Brian O. Casey  
President and Chief Executive Officer



Susan M. Byrne  
Chairman and Chief Investment Officer



# Enriching

## Our Growth Potential

Offering our WHG Funds to the institutional mutual fund market enables us to leverage our products, investment process and established relationships as we expand our growth opportunities.





“We believe we can deliver the same solid performance and service in the mutual fund market as we do in the institutional and high net worth markets.”

**W**e are expanding our growth potential by targeting the important mutual fund market. Not only is the market large – more than \$10 trillion in assets – it is also a logical extension of our institutional business. Many of our clients have both defined benefit and defined contribution plans. Our institutional mutual funds provide a solution for their defined contribution needs.

Our first WHG Funds – WHG SMidCap (WHGMX) and WHG Income Opportunity (WHGIX) – launched in late 2005. We added WHG LargeCap Value (WHGLX) and WHG Balanced (WHGBX) in 2006. At year-end 2006, our family of four mutual funds topped \$130 million in assets – a major accomplishment given that two-thirds of existing mutual funds have assets of less than \$100 million. We expect to expand our WHG Funds offerings with our SmallCap Value and AllCap Value products at the appropriate time.

We have configured our current WHG Funds product offerings to meet the specific requirements of the institutional mutual fund marketplace. Specifically, we have capped the funds’ expense ratios at competitive levels. In 2006, we lowered the minimum investment for the WHG Funds to \$5,000 from \$100,000, so that we now offer retail investors access to these institutional products. Our funds are distributed through SEI Investments Distribution Co., a best-in-class mutual fund outsourcing firm. The funds are also currently available on third-party platforms including Charles Schwab, Fidelity, RBC Dain Rauscher, Bear Stearns and Baird.

Going forward, we believe we can deliver the same solid performance and service in the mutual fund market as we do in the institutional and high net worth markets. Leveraging our product family, investment discipline and existing infrastructure to capture growth through our WHG Funds is an exciting and promising opportunity for Westwood.

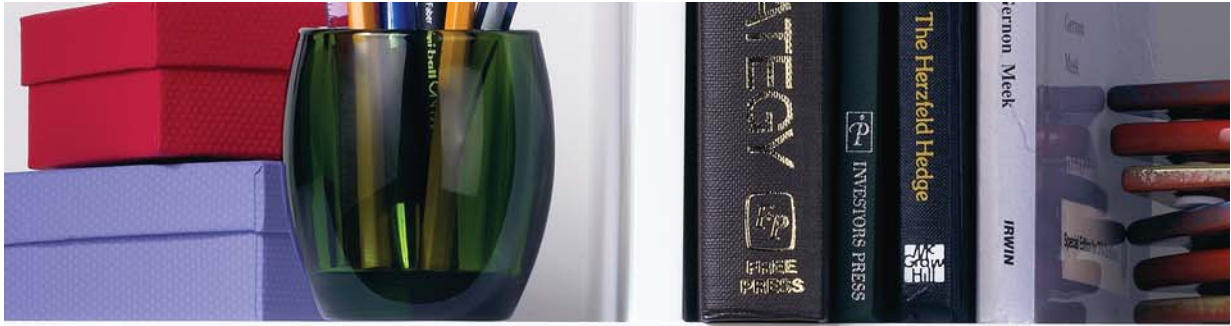


WHG SMidCap Fund  
**WHGMX**

WHG Income  
Opportunity Fund  
**WHGIX**

WHG LargeCap  
Value Fund  
**WHGLX**

WHG Balanced Fund  
**WHGBX**



# Pursuing Growth

Top-quartile performance, attentive service, strong relationships  
– these are our unchanging goals in the institutional market,  
the largest of our three distinct markets.



“By investing with discipline, our experienced and talented team of professionals has delivered strong performance for more than two decades.”

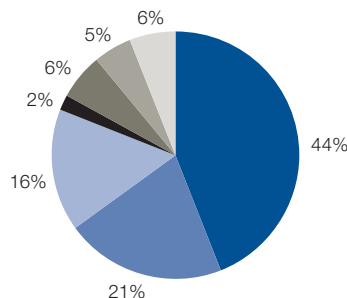
**W**e continue to drive growth through the institutional market by striving to generate performance in the top quartile of our peer groups, by attentively serving our clients, and by continuing to maintain and cultivate relationships with institutional consultants. The institutional market remains our largest market. Approximately 75 percent of the assets under our management belong to institutional clients such as corporate pension funds, public retirement plans, endowments and foundations.

In striving to generate top-quartile performance, we adhere to our established investment philosophy. We believe that superior long-term results are best achieved by controlling downside risk. We strictly adhere to our investment process as we pursue superior risk-adjusted returns for our clients. By investing with discipline, our experienced and talented team of professionals has delivered strong performance for more than two decades. In 2006, most of our products outperformed their benchmarks and were in the top quartile of their peer group. In particular, our SMidCap Value, SmallCap Value and Income Opportunity products delivered especially strong performance in 2006.

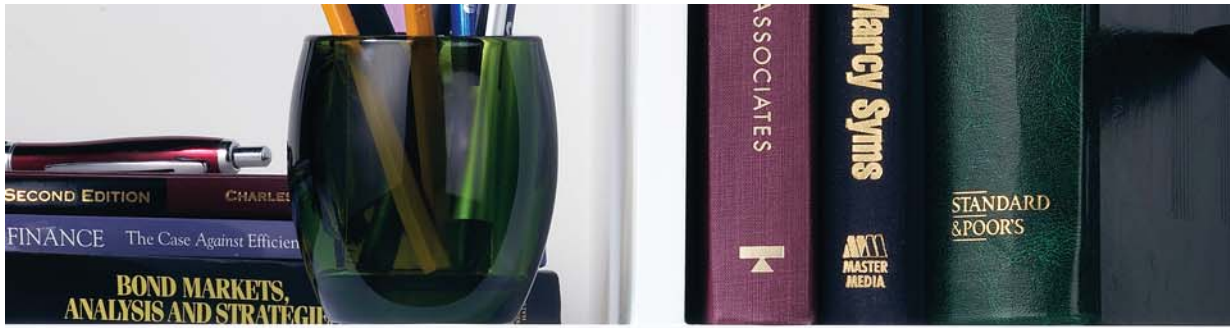
We plan to introduce our SmallCap Value product to the institutional marketplace in 2007. We believe there is a relative shortage in the marketplace of small cap products that are open to new investors. As a result, we hope to see a positive reception for SmallCap Value now that it has exceeded \$100 million in assets and built a solid three-year track record. We plan to introduce our AllCap Value product to the institutional market when it reaches the same milestones in asset level and track record.

Just as we are committed to delivering strong performance, we are also committed to delivering attentive service to our valued clients. In 2006, we conducted more than 280 client meetings, reaching more than 90 percent of all clients who prefer this method of service. Our professionals never forget that the money we manage belongs to our clients. We provide the information each client needs – when, where and how they need it – with a commitment to integrity, honesty and excellence.

**2006 Assets Under Management by Account Type**



- Separate Accounts
- Commingled Funds
- Sub-Advisory
- WHG Funds
- Westwood Funds
- Managed Accounts
- Other



# Fostering Consistent Growth

Westwood Trust delivers custom asset solutions and excellent service to each of its valued clients, resulting in consistent growth in assets under management.



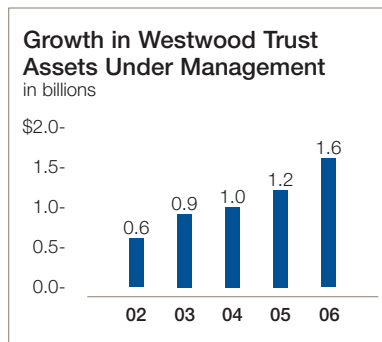
“Our reputation for excellent service, strong returns and absolute discretion has resulted in a very loyal client base and a steady flow of referrals.”

**W**estwood Trust provides investment management, custody and trust services to high net worth individuals and small to mid-size institutions. Our reputation for excellent service, strong returns and absolute discretion has resulted in a very loyal client base and a steady flow of referrals.

We use a consultative process designed to help each client achieve their goals. We offer our Enhanced Balanced™ asset allocation model that offers access to multiple managers and asset classes, providing our clients with diversification and exposure to a variety of investment styles through a single relationship. It also provides flexibility – delivered at a competitive fee structure – to customize an asset mix to reflect individual investment objectives and risk tolerance. Our Enhanced Balanced™ model has consistently provided clients with returns in excess of market benchmarks at reduced levels of risk.

Westwood Trust has also been an effective product development platform for our company. New products, such as our SmallCap Value and Income Opportunity products, were launched first to our trust clients. After delivering solid performance for at least three years and accumulating \$100 million in assets, the products are then introduced to the institutional marketplace. This approach benefits clients in both markets by providing Westwood Trust clients early access to new products and providing institutional clients the proven track record they require.

The value that our clients see in our investment returns and service is evident in the growth that Westwood Trust has achieved. Assets under management reached \$1.6 billion by year-end 2006, a compound annual growth rate of 19.9 percent over the past five years. In 2006, we added a number of new clients and expanded our support staff to maintain the excellent service levels we are known for at Westwood. Going forward, we are committed to delivering the performance and service that our loyal clients have come to expect from Westwood Trust.



Our Enhanced Balanced™ model has consistently provided clients with returns in excess of market benchmarks at reduced levels of risk.

# Turning Growth Opportunities Into Results

Exciting growth opportunities. A diversified product family with a strong performance record. Well-defined distribution strategies. Most importantly, a talented, experienced team of professionals. Bottom line, it is our employees who turn our growth opportunities and strategies into superior results.









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**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-K**

**(Mark One)**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-31234

**WESTWOOD HOLDINGS GROUP, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**200 Crescent Court, Suite 1200**

**Dallas, Texas 75201**

(Address of principal executive offices)

**75-2969997**

(I.R.S. Employer Identification No.)

**75201**

(Zip Code)

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

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

Title of each class:	Name of each exchange on which registered:
Common Stock, par value \$0.01 per share	New York Stock Exchange

**SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:** None

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

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

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

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

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

Large accelerated filer \_\_\_ Accelerated filer X Non-accelerated filer \_\_\_

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

The aggregate market value on June 30, 2006 of the voting and non-voting common equity held by non-affiliates of the registrant was \$90,274,630. For purposes of this calculation, the registrant has assumed that stockholders that are not officers or directors of the registrant are not affiliates of the registrant.

The number of shares of registrant's Common Stock, par value \$0.01 per share, outstanding as of February 20, 2007: 6,638,525.

**DOCUMENTS INCORPORATED BY REFERENCE**

Selected portions of the registrant's definitive Proxy Statement for the 2007 Annual Meeting of Stockholders are incorporated by reference into Part III hereof.

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**WESTWOOD HOLDINGS GROUP, INC.**

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## PART I

### Item 1. Business.

*Unless the context otherwise requires, the term “we,” “us,” “our,” “Westwood,” or “Westwood Holdings Group” when used in this Form 10-K (“Report”) and in the Annual Report to the Stockholders refers to Westwood Holdings Group, Inc., a Delaware corporation, and its consolidated subsidiaries and predecessors taken as a whole. This Report contains some forward-looking statements within the meaning of the federal securities laws. Actual results and the timing of some events could differ materially from those projected in or contemplated by the forward-looking statements due to a number of factors, including without limitation those set forth under “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Item 1A. Risk Factors”.*

#### **General**

We manage investment assets and provide services for our clients through our two subsidiaries, Westwood Management Corp. (“Westwood Management”) and Westwood Trust. Westwood Management provides investment advisory services to corporate pension funds, public retirement plans, endowments and foundations, a family of institutional mutual funds which we call the WHG Funds, other mutual funds and clients of Westwood Trust. Westwood Trust provides trust and custodial services and participation in common trust funds that it sponsors to institutions and high net worth individuals. Our revenues are generally derived from fees based on a percentage of assets under management, and at December 31, 2006, Westwood Management and Westwood Trust collectively managed assets valued at approximately \$5.9 billion. We have been providing investment advisory services since 1983 and, according to recognized industry sources, including Morningstar, Inc., when measured over multi-year periods of ten years and longer, our principal asset classes rank above the median in performance within their peer groups.

The core of our business is dependent on our client relationships. We believe that in addition to investment performance, client service is paramount in the asset management business. As such, a major focus of our business strategy is to continue building strong relationships with clients to better enable us to anticipate their needs and to satisfy their investment objectives. Our team approach is designed to result in efficient, responsive service for our clients. Our future success is dependent to a significant degree on both investment performance and our ability to provide responsive client service.

We were incorporated under the laws of the State of Delaware on December 12, 2001 as a subsidiary of SWS Group, Inc. (“SWS”). On June 28, 2002, SWS completed the spin-off of us by effecting a dividend distribution of all of our common stock held by SWS to all of its stockholders on a pro rata basis. We are an independent public company, and our common stock is listed on the New York Stock Exchange under the ticker symbol “WHG.” We are a holding company, and our principal assets consist of the capital stock of Westwood Management and Westwood Trust.

We maintain a website at [www.westwoodgroup.com](http://www.westwoodgroup.com). Information found on our website is not intended to be a part of this Report. All filings made by us with the Securities and Exchange Commission (“SEC”), including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are available without charge on our website. Additionally, our Code of Business Conduct and Ethics, our Corporate Governance Guidelines, our Audit Committee Charter, our Compensation Committee Charter and our Governance/Nominating Committee Charter are available without charge on our website. Stockholders also may obtain print copies of these documents free of charge by submitting a written request to William R. Hardcastle, Jr. at the address set forth in the front of this Report.

#### **Westwood Management**

##### *General*

Westwood Management provides investment advisory services to large institutions, including corporate pension funds, public retirement plans, endowments and foundations, having at least \$10 – \$25 million in investable assets,

depending on the asset class. Westwood Management also provides advisory services to the WHG Funds and subadvisory services to other mutual funds. Our overall investment philosophy is determined by our chief investment officer, Susan M. Byrne, and, with respect to the bulk of assets under management, is a value-oriented approach that is focused on achieving a superior, risk-adjusted return by investing in companies that are positioned for growth but are not fully recognized as such in the marketplace. This investment approach is designed to preserve capital in unfavorable periods and to provide superior real returns over the long term. Ms. Byrne has over 30 years of investment experience. Westwood Management's investment advisory team also possesses substantial investment management experience, including a number of investment management, research and trading professionals. The continuity of the team and its years of experience are critical elements in successfully managing investments.

### *Managed Asset Classes*

*Asset Management.* We provide clients with a broad range of investment asset classes designed to meet varying investment objectives. This affords our clients the opportunity to meet their investment objectives through the use of one investment adviser. More than half of our assets under management are invested in our LargeCap Value asset class. The following sets forth the principal asset classes currently managed by Westwood Management:

*LargeCap Value:* Investments in equity securities of approximately 45-60 well-seasoned companies with market capitalizations generally over \$1 billion. Our strategy for this portfolio is to invest in companies where we expect that future profitability, driven by operational improvements, will be higher than expectations reflected in current share prices.

*SMidCap Value:* Investments in equity securities of approximately 45-60 companies with market capitalizations between \$100 million and \$1 billion. Similar to the LargeCap Value asset class, we seek to discover the same kinds of operational improvements that are driving earnings growth, but within small to mid-size companies that can be purchased inexpensively.

*SmallCap Value:* Investments in equity securities of approximately 50-70 companies with market capitalizations between \$100 million and \$2.5 billion. Similar to the LargeCap Value and SMidCap Value classes, we seek to invest in high quality companies where earnings growth is driven by operational improvements that are not fully recognized by the market.

*AllCap Value:* Investments in equity securities of approximately 60-80 well-seasoned companies. The portfolio is generally comprised of the best ideas within all market capitalizations above \$100 million. Similar to the LargeCap Value asset class, we seek to invest in companies where we expect that future profitability, driven by operational improvements, will be higher than expectations reflected in current share prices across a broad range of market capitalizations.

*Real Estate Investment Trusts (or REITs):* Investments in the publicly traded equity securities of approximately 50 real estate investment trusts. Our investment process involves making investment selections based on qualitative research of high quality REITs.

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

*Income Opportunity:* Investments in dividend-paying common stocks, straight and convertible preferred stock, master limited partnerships, REITs and selected debt instruments. The portfolio strategy focuses on companies with strong and improving cash flow sufficient to support a sustainable or rising income stream for investors. This asset class is targeted towards investors seeking high current income through dividend-paying and/or interest-bearing securities.

*Fixed Income Core/Intermediate Bonds:* Investments in high-grade, intermediate term, corporate and government bonds. We seek to add value to client portfolios through yield curve positioning and investment in improving credit quality.

Each asset class is a portfolio of equity and/or fixed income securities selected by Westwood Management's portfolio teams to best provide the long term returns consistent with Westwood Management's investment philosophy. Our portfolio teams make decisions for all of Westwood Management's asset classes in accordance with the investment objectives and policies of such asset classes, including determining when and which securities to purchase and sell.

We primarily employ a value-oriented approach in managing the bulk of our equity asset classes. The common thread that permeates throughout our investment strategies is our focus on a disciplined approach to controlling risk and preserving the core value of the assets under management whenever possible. Our value oriented asset classes have a greater emphasis on identifying companies where earnings result from actual operational improvements and not manufactured improvements occurring through financial statement adjustments. Our desire to prevent the loss of the core value of the assets under management is the overriding objective of this strategy, even if the cost is the loss of opportunity for potentially higher returns. Whether through investments in industry leaders or in companies that provide steady and stable growth, Westwood Management seeks to consistently demonstrate superior performance relative to industry peers and the broad market.

More than two-thirds of our assets under management are invested in equity securities of companies with a large market capitalization. When measured over multi-year periods, ten years and longer, Westwood Management's principal asset classes rank above the median within their peer groups in performance according to recognized industry sources, including Morningstar, Inc. For the ten-year period ended on December 31, 2006, our LargeCap Value and Balanced asset classes rank in the top quartile in their peer groups.

Our ability to grow our assets under management is dependent on our competitive long-term performance record and our strong relationships with investment consulting firms throughout the nation. We are continually looking for opportunities to expand our asset classes in terms of growing our existing asset classes and developing new portfolios focusing on investment areas that are not currently part of our asset classes under management. We primarily intend to grow our asset classes internally, but may also consider acquiring new asset classes from third parties, as discussed under "--Growth Strategy" below. Our growth strategy not only provides our clients more investment opportunities, but also diversifies our assets under management, thereby reducing our risk in any one area of investment and increasing our competitive ability to attract new clients.

*Cash Management.* Westwood Management also provides cash management and custodial services for the cash reserve funds of SWS. The SWS cash reserve funds totaled \$172 million at December 31, 2006.

#### *Advisory and Subadvisory Service Agreements*

Westwood Management manages accounts of its clients under investment advisory and subadvisory agreements. As is common in the asset management industry, these agreements are usually terminable upon short notice and provide for compensation based on the market value of the client's assets under management. Westwood Management's advisory fees are paid quarterly in advance based on the assets under management on the last day of the preceding quarter, quarterly in arrears based on the assets under management on the last day of the quarter just ended, or are based on a daily or monthly analysis of assets under management for the stated period. Revenue from advance payments is deferred and recognized over the period that services are performed. Pursuant to these agreements, Westwood Management provides overall investment management services, including directing investments in conformity with the investment objectives and restrictions imposed by the clients. Unless otherwise directed in writing by our client, Westwood Management has the authority to vote all proxies with respect to a client's assets.

Westwood Management is also a party to subadvisory agreements with other investment advisors under which it performs substantially the same services as it does under its advisory agreements. However, the investment strategy adopted for a particular client is subject to supervision and review by the client. Our subadvisory fees are computed based upon the daily net assets of the client and are payable on a monthly basis. As with our advisory agreements, these agreements are terminable upon short notice.

Under our subadvisory agreement with Gabelli Advisers, Inc., Westwood Management provides investment advisory services to the Westwood Funds family of mutual funds. The Westwood Equity Fund is a large cap value fund with assets consisting of securities valued at approximately \$187 million as of December 31, 2006. For the ten-year period ended on December 31, 2006, the Westwood Equity Fund ranked in the 27<sup>th</sup> percentile in the Large Value category according to Morningstar, Inc. Westwood Management owns shares of Class A Common Stock representing a 19.02% economic interest in Gabelli Advisers, Inc., a subsidiary of GAMCO Investors, Inc. Based on SEC filings, we believe that GAMCO Investors, Inc. owned 19.0% of our common stock as of December 31, 2006. Westwood Management received subadvisory payments of \$863,000, \$780,000 and \$889,000 for the twelve months ended December 31, 2006, 2005 and 2004, respectively.

While Westwood Management provides subadvisory services with respect to the Westwood Funds family of funds, Westwood Management provides investment advisory services directly to the WHG Funds family of mutual funds, namely the WHG SMidCap Fund, the WHG Income Opportunity Fund, the WHG LargeCap Value Fund and the WHG Balanced Fund.

Our four largest clients accounted for approximately 25.6% of total revenues for the twelve months ended December 31, 2006.

### ***Westwood Trust***

#### *General*

Westwood Trust provides trust and custodial services and participation in common trust funds that it sponsors to institutions and high net worth individuals generally having at least \$1 million in assets under management. Westwood Trust seeks to define and improve the risk/return profile of the client's investment portfolio by complementing or enhancing existing investment strategies. Westwood Trust also provides back office services to its clients, including tax reporting, distribution of income to beneficiaries, preparation of trust and account statements and attending to the special needs of particular trusts, as well as serves as trustee for tax and estate-planning purposes, and for special needs trusts. Westwood Trust is chartered and regulated by the Texas Department of Banking.

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

#### *Services*

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

#### *Common Trust Funds*

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



### *Enhanced Balanced Portfolios*

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

### *Distribution Channels*

We market our services through several distribution channels that allow us to expand the reach of our investment advisory services. These channels provide us the ability to leverage the existing distribution infrastructure and capabilities of other financial services firms and intermediaries and focus on our core competency of developing outstanding investment asset classes.

### *Institutional Investment Consultants*

Investment management consulting firms serve as gatekeepers to a large percentage of corporate pension plans, endowments and foundations, which represent Westwood's primary client markets. Consultants provide guidance and expertise in setting a client's asset allocation strategy, as well as the establishment of an investment policy. In addition, consultants make recommendations of investment firms that they believe will best meet their client's investment objectives. We have established strong relationships with many national and regional investment consulting firms, which has resulted in us being considered and hired by many of their clients. Continuing to enhance our existing consulting firm relationships, as well as forging new relationships, serves to increase the awareness of our services in both the consultant community and the underlying institutional client base.

### *Subadvisory Relationships*

Our subadvisory relationships allow us to extend the reach of our investment management services to the clients of other investment companies that have broad, established distribution capabilities. In subadvisory arrangements, our client is typically the investment company through which our services are offered to investors. In these subadvisory arrangements, our investment advisory services are typically made available through retail-based mutual fund offerings. The investment company that sponsors the mutual fund is responsible for marketing, distribution, operations and accounting related to these funds.

### *Managed Accounts*

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

### *Growth Strategy*

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

- generate growth from new and existing clients and consultant relationships,
- attract and retain key employees,
- grow assets in our additional asset classes,
- foster continued growth of the Westwood Trust platform,
- foster expanded distribution via mutual funds,
- pursue strategic acquisitions and alliances, and

- continue to strengthen our brand name.

*Generate growth from new and existing clients and consultant relationships.* As our primary business objective, we intend to maintain and enhance existing relationships with clients and investment consultants by continuing to provide solid investment performance and a high level of quality service to these existing relationships. Additionally, we intend to pursue growth through targeted sales and marketing efforts that emphasize our investment performance and superior client service. New institutional client accounts are generally derived through investment consultants, and we have been successful in developing solid long-term relationships with many national and regional investment consultants. The familiarity with our firm, our people and our processes that we have built in these relationships is one of the key factors in being considered for new client investment mandates.

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

*Grow assets in our additional asset classes.* While LargeCap Value is our flagship product, we continue to develop additional asset classes in response to client needs and opportunities we see in the marketplace. Westwood Management has managed our SMidCap Value asset class with solid results for clients at Westwood Trust for several years. We began marketing SMidCap Value to institutions in late 2004 and as of December 31, 2006, we had approximately \$880 million under management in that asset class. We have also developed additional new asset classes in recent years that we intend to introduce to the institutional marketplace at the appropriate time in the future. SmallCap Value now has a three-year track record, Income Opportunity now has a four-year track record and AllCap Value will soon have a five-year track record. We believe that we have the team in place to fully support these new products in the institutional marketplace. We plan to begin marketing our SmallCap Value asset class to existing clients and institutional investment consultants during 2007. If we continue to deliver strong performance, we believe the demand for these asset classes can provide meaningful growth in our assets under management in the future.

*Foster continued growth of the Westwood Trust platform.* Westwood Trust has experienced solid growth in serving small- to medium-sized institutions and high net worth individuals. We are seeing a growing level of interest from our clients in the diversified, highly attentive service model that we have developed. We believe the continued acceptance of our Enhanced Balanced product, which offers diversified exposure to multiple asset classes in a tax efficient, comprehensive solution for clients, provides us with opportunities for future growth.

*Foster expanded distribution via mutual funds.* In December 2005, we launched two new mutual funds, the WHG SMidCap Fund and the WHG Income Opportunity Fund, and in 2006, we launched two additional mutual funds, the WHG LargeCap Value Fund and the WHG Balanced Fund. The WHG Funds, which mirror our institutional strategies, offer capped expense ratios in an institutional share class. We believe that access to our SMidCap Value, Income Opportunity, LargeCap Value and Balanced asset classes via an institutional mutual fund vehicle will present an attractive offering for certain segments of institutional investors, including 401(k) plans.

*Pursue strategic acquisitions and alliances.* We will evaluate strategic acquisition, joint venture and alliance opportunities carefully. We may, in time, have an interest in pursuing asset management firms or trust companies that have assets with respect to which we have expertise or those that appear appropriate as a means of expanding the range of asset classes or services we offer or expanding our distribution capabilities. By acquiring investment firms that successfully manage asset classes in which we do not specialize, we could attract new clients and provide our existing clients with a more diversified range of asset classes. We may also consider entering into alliances with other financial services firms that would allow us to leverage our core competency of developing superior investment products in combination with alliance partners that could provide us with enhanced distribution capabilities or provide our clients with access to additional service offerings.

*Continue strengthening our brand name.* We believe that the strength of our brand name has been a key component to our long-term tenure in the investment industry and will continue to be instrumental to our future success. We have developed our strong brand name largely through high profile coverage in various investment publications and electronic media. A number of our investment professionals, including Ms. Byrne and David S. Spika, Investment Strategist, enjoy a visible presence in print and electronic media, which we believe also enhances our brand name. We will continue to look for creative ways to strengthen our brand name and reputation in our target client markets.

### ***Competition***

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

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

We compete against an ever-increasing number of investment dealers, banks, insurance companies and others that sell equity funds, taxable income funds, tax-free investments and other investment products. In addition, the allocation by many investors of assets away from active equity investment to index funds, fixed income or similar asset classes has enhanced the ability of firms offering non-equity asset classes and passive equity management to effectively compete with us. In short, the competitive landscape in which we operate is both intense and dynamic, and there can be no assurance that we will be able to compete effectively in the future as an independent company.

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

### ***Regulation***

#### *Westwood Management*

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

Our business is subject to regulation at both the federal and state level by the SEC and other regulatory bodies. Westwood Management is registered with the SEC under the Investment Advisers Act of 1940 and under the laws of various states. As a registered investment adviser, Westwood Management is regulated and subject to examination by the SEC. The Investment Advisers Act imposes numerous obligations on registered investment advisers, including fiduciary duties, record keeping requirements, operational requirements, marketing requirements and disclosure obligations. In addition, Westwood Management acts as adviser to the recently launched mutual funds, the WHG Funds, which are registered with the SEC under the Investment Company Act of 1940. As adviser to a registered investment company, Westwood Management must comply with the requirements of the Investment Company Act and related regulations. The

Investment Company Act imposes numerous obligations on registered investment companies, including requirements relating to operations, fees charged, sales, accounting, record-keeping, disclosure, governance and restrictions on transactions with affiliates. Under the rules and regulations of the SEC promulgated pursuant to the federal securities laws, we are subject to periodic examination by the SEC. The SEC is authorized to institute proceedings and impose sanctions for violations of the Investment Advisers Act and the Investment Company Act, ranging from censure to termination of an investment adviser's registration. The failure of Westwood Management to comply with the requirements of the SEC could have a material adverse effect on Westwood. We must also comply with anti-money laundering laws and regulations, including the USA PATRIOT Act of 2001. We believe that we are in substantial compliance with the requirements of the regulations under the Investment Advisers Act, the Investment Company Act and the USA PATRIOT Act.

#### *Westwood Trust*

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

- minimum capital maintenance requirements;
- restrictions on dividends;
- restrictions on investments of restricted capital;
- lending and borrowing limitations;
- prohibitions against engaging in certain activities;
- periodic examinations by the office of the Texas Department of Banking Commissioner;
- furnishing periodic financial statements to the Texas Department of Banking Commissioner;
- fiduciary record-keeping requirements; and
- prior regulatory approval for certain corporate events (such as mergers, sale/purchase of all or substantially all of the assets and transactions transferring control of a trust company).

The Finance Code also gives the Banking Commissioner broad regulatory powers (including penalties and civil and administrative actions) if the trust company violates certain provisions of the Finance Code or conservatorship or closure if Westwood Trust is determined to be in a "hazardous condition" (as the law defines that term).

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

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

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

#### *Employees*

At December 31, 2006, we had 48 full-time employees, including 20 investment management, research and trading professionals, 13 marketing and client service professionals and 15 operations and business management professionals. None of our employees are represented by a labor union, and we consider our employee relations to be good.

***Segment information***

For information about our operating segments, Westwood Management and Westwood Trust, please see footnote 10 “Segment Information” in the financial statements accompanying this Report.

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

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

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

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

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

We believe that our future success will depend to a significant extent upon the services of our executive officers, particularly Susan M. Byrne, our Chairman of the Board and Chief Investment Officer, and Brian O. Casey, our President and Chief Executive Officer. As with other asset management businesses, our future performance depends to a significant degree upon the continued contributions of these and certain other officers, investment professionals and other key marketing, client service and management personnel. There is substantial competition for these types of skilled personnel. The loss of the services of one or more of our key employees or our failure to attract, retain and motivate qualified personnel could negatively impact our business, financial condition, results of operations and future prospects.

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

Our results of operations are affected by many economic factors, including the performance of the securities markets. Negative performance in the securities markets or certain segments of those markets, or short-term volatility in the securities markets or segments thereof, could result in investors withdrawing assets from the markets or decreasing their rate of investment, either of which could reduce our revenues. Because most of our revenues are based on the value of assets under management, a decline in the value of those assets would also adversely affect our revenues. In addition, in periods of slowing growth or declining revenues, profits and profit margins are adversely affected because certain expenses remain relatively fixed.

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

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

We have incurred significant costs over the last several years to develop new asset classes, including SMidCap Value, SmallCap Value, AllCap Value and Income Opportunity, to launch four new mutual funds, the WHG SMidCap Fund, the WHG Income Opportunity Fund, the WHG LargeCap Value Fund and the WHG Balanced Fund and also to upgrade our business infrastructure. Some of the costs associated with these improvements will continue to be incurred in future periods and are relatively fixed. We may not realize the benefits of these investments and, in the event we are not able to do so, our growth opportunities may be adversely affected.

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

The development and marketing of new asset classes in our industry requires a substantial amount of time and financial resources. Our ability to successfully market and sell a new asset class depends on our financial resources, the performance results of the asset class, the timing of the offering and our marketing strategies. Once an asset class is developed, whether through acquisition or internal development, we must still effectively market the asset class to our existing and prospective clients. This entails incurring significant financial expenses related to research on the target assets and the demand for such asset class in the market, as well as sales and marketing costs associated with attracting assets to the new asset class. In addition, our ability to sell new asset classes to our existing and prospective clients depends on our ability to meet or exceed the performance of our competitors who offer the same or similar asset classes. We may not be able to profitably manage the assets within a given asset class. Moreover, it may take years before we are able to produce the level of results that will enable us to attract clients. If we are unable to realize the benefits of the costs and expenses incurred in developing new asset classes, we may experience losses as a result of our management of these asset classes, and our ability to introduce further new asset classes and compete in our industry may be hampered.

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

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

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

Our largest four clients accounted for 25.6% of total revenues for the twelve months ended December 31, 2006, and we are therefore dependent to a significant degree on our ability to maintain our existing relationships with these clients. There can be no assurance that we will be successful in maintaining these existing client relationships or in securing additional clients. Any failure by us to retain one or more of these large clients or establish profitable relationships with additional clients could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

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

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

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

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

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

Our investment professionals handle a significant amount of assets, financial and personal information for our clients. Although we have implemented a system of controls to minimize the risk of fraudulent taking or misuse of assets and information, there can be no assurance that our controls will be adequate to prevent taking or misuse by our portfolio managers or employees. If our controls are ineffective in preventing the fraudulent taking or misuse of assets and information, we could be subject to costly litigation, which could consume a substantial amount of our resources and distract our management from our operations and could also result in regulatory sanctions. Additionally, any such fraudulent actions could adversely affect some of our clients in other ways, and these clients could seek redress against us.

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

As part of our long-term business strategy, we may consider acquisitions of similar or complementary businesses. See “-- Growth Strategy.” If we are not correct when we assess the value, strengths, weaknesses, liabilities and potential profitability of acquisition candidates or if we are not successful in integrating the operations of the acquired businesses, the success of the combined business could be compromised. Any future acquisitions will be accompanied by the risks commonly associated with acquisitions. These risks include, among others, potential exposure to unknown liabilities of acquired companies and to acquisition costs and expenses, the difficulty and expense of integrating the operations and personnel of the acquired companies, the potential disruption to the business of the combined company and potential diversion of management's time and attention, the impairment of relationships with and the possible loss of key employees and clients as a result of the changes in management, potential future write-downs related to goodwill impairment in connection with acquisitions, and dilution to the stockholders of the combined company if the acquisition is made for stock of the combined company. In addition, asset classes, technologies or businesses of acquired companies may not be effectively assimilated into our business or have a positive effect on the combined company's revenues or earnings. The combined company may also incur significant expense to complete acquisitions and to support the acquired asset classes and businesses. Further, any such acquisitions may be funded with cash, debt or equity, which could have the effect of diluting the holdings or limiting the rights of stockholders. Finally, we may not be successful in identifying attractive acquisition candidates or completing acquisitions on favorable terms.



**We are a holding company and are dependent on the operations and funds of our subsidiaries.**

We are a holding company, with no revenue generating operations and no assets other than our ownership interests in Westwood Management and Westwood Trust. Accordingly, we are dependent on the cash flow generated by these operating subsidiaries and must rely on dividends or other intercompany transfers from these operating subsidiaries to generate the funds necessary to meet our obligations.

**Various factors may hinder the declaration and payment of dividends.**

We have historically paid a quarterly dividend. However, the payment of dividends in the future is subject to the discretion of our Board of Directors, and various factors may prevent us from paying dividends. Such factors include our financial position, capital requirements and liquidity, the existence of a stock repurchase program, any loan agreement restrictions, state corporate and banking law restrictions, results of operations and such other factors as our Board of Directors may consider relevant. In addition, as a holding company, our ability to pay dividends is dependent on the dividends and income we receive from our subsidiaries. At the present time our primary source of cash is dividends that may be received from Westwood Management or Westwood Trust. The payment of dividends by Westwood Management or Westwood Trust is subject to the discretion of their Boards of Directors and compliance with applicable laws, including, in particular, the provisions of the Texas Finance Code applicable to Westwood Trust. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

**Our business is vulnerable to systems failures that could have a material adverse effect on our business, financial condition and results of operations.**

Any delays or inaccuracies in securities pricing information or information processing could give rise to claims against us, which could have a material adverse effect on our business, financial condition and results of operations. We are highly dependent on communications and information systems and on third party vendors for securities pricing information and updates from certain software. We may suffer a systems failure or interruption, whether caused by an earthquake, fire, other natural disaster, power or telecommunications failure, unauthorized access, act of God, act of war or otherwise, and our back-up procedures and capabilities may not be adequate or sufficient to eliminate the risk of extended interruptions in operations.

**We may not be able to fund future capital requirements on favorable terms if at all.**

We cannot be certain that financing to fund our working capital or other cash requirements, if needed, will be available on favorable terms, if at all. Our capital requirements will vary greatly from quarter to quarter depending on, among other things, capital expenditures, fluctuations in our operating results and financing activities. If future financing is necessary, we may or may not be able to obtain financing on favorable terms, if at all. Further, any future equity financings could dilute the relative percentage ownership of the then existing holders of our common stock, and any future debt financings could involve restrictive covenants that limit our ability to take certain actions.

**Failure to maintain effective internal controls could have a material adverse effect on our business and stock price.**

Effective internal controls are necessary for us to provide reliable financial reports. If we cannot provide reliable financial reports, our brand and operating results could be harmed. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

While we continue to evaluate and improve our internal controls, we cannot be certain that these measures will ensure that we implement and maintain adequate controls over our financial processes and reporting in the future. Any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations. If we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal control over financial reporting in

accordance with Section 404 of the Sarbanes-Oxley Act. In addition, failure to achieve and maintain an effective internal control environment could cause investors to lose confidence in our reported financial information, which could have a material adverse effect on our stock price.

**Our organizational documents contain provisions that may prevent or deter another group from paying a premium over the market price to our stockholders to acquire our stock.**

Our organizational documents contain provisions that require a vote of two-thirds of the shares of stock entitled to vote to remove directors for cause, establish that stockholders cannot act by written consent, and that authorize our board of directors to issue, without shareholder approval, blank check preferred stock. In addition, as a Delaware corporation, we are subject to Section 203 of the Delaware General Corporation Law relating to business combinations. These provisions could delay, deter or prevent a merger, consolidation, tender offer or other business combination or change of control involving us that could include a premium over the market price of our common stock that some or a majority of our stockholders might consider to be in their best interests.

**Item 1B. Unresolved Staff Comments.**

Not applicable.

**Item 2. Properties.**

Westwood, Westwood Management and Westwood Trust conduct their principal operations through a leased property with approximately 21,600 square feet located in Dallas, Texas. The lease agreement expires in May 2011. We believe these facilities will be adequate to serve our currently anticipated business needs.

**Item 3. Legal Proceedings.**

We are subject from time to time to certain claims and legal proceedings arising in the ordinary course of our business. We do not believe the outcome of these proceedings will have a material impact on our financial position, operations or cash flow.

**Item 4. Submission of Matters to A Vote of Security Holders.**

No matter was submitted to a vote of our stockholders during the quarterly period ended December 31, 2006.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

#### Market Information

Our common stock has traded on the New York Stock Exchange under the symbol "WHG" since July 1, 2002. At December 31, 2006, there were approximately 168 record holders of our common stock, although we believe that the number of beneficial owners of our common stock is substantially greater. The table below sets forth the high and low sale prices for the common stock, as reported by the New York Stock Exchange for the periods indicated.

	<u>High</u>	<u>Low</u>
<b>2006</b>		
Fourth Quarter .....	\$26.74	\$19.75
Third Quarter .....	20.15	18.00
Second Quarter .....	19.99	18.08
First Quarter .....	20.15	18.00
<b>2005</b>		
Fourth Quarter .....	\$18.66	\$17.75
Third Quarter .....	19.45	17.75
Second Quarter .....	19.10	16.00
First Quarter .....	20.20	18.80

#### Dividends

We have declared a cash dividend on our common stock for each quarter since the date that our common stock was first publicly traded. The table below sets forth the quarterly and special dividends declared for the periods indicated.

	<u>Quarterly</u>	<u>Special</u>
<b>2006</b>		
Fourth Quarter .....	\$0.15	-
Third Quarter .....	0.15	\$0.85
Second Quarter .....	0.09	-
First Quarter .....	0.09	-
<b>2005</b>		
Fourth Quarter .....	\$0.09	-
Third Quarter .....	0.09	\$0.75
Second Quarter .....	0.08	-
First Quarter .....	0.08	-

In addition, on February 7, 2007 we declared a quarterly cash dividend of \$0.20 per share on our common stock payable on April 2, 2007 to stockholders of record on March 15, 2007. We currently intend to continue paying cash dividends in such amounts as our board of directors determines is appropriate. Any payment of cash dividends in the future will be at the discretion of the board of directors and subject to some limitations under the Delaware General Corporation Law.

Westwood Holdings Group, Inc. is the sole stockholder of both Westwood Management and Westwood Trust. Westwood Trust is limited under applicable Texas law in the payment of dividends to undivided profits which is defined as that part of equity capital equal to the balance of net profits, income, gains, and losses since its formation date minus subsequent distributions to stockholders and transfers to surplus or capital under share dividends or appropriate board of director resolutions.

## EQUITY COMPENSATION PLAN INFORMATION

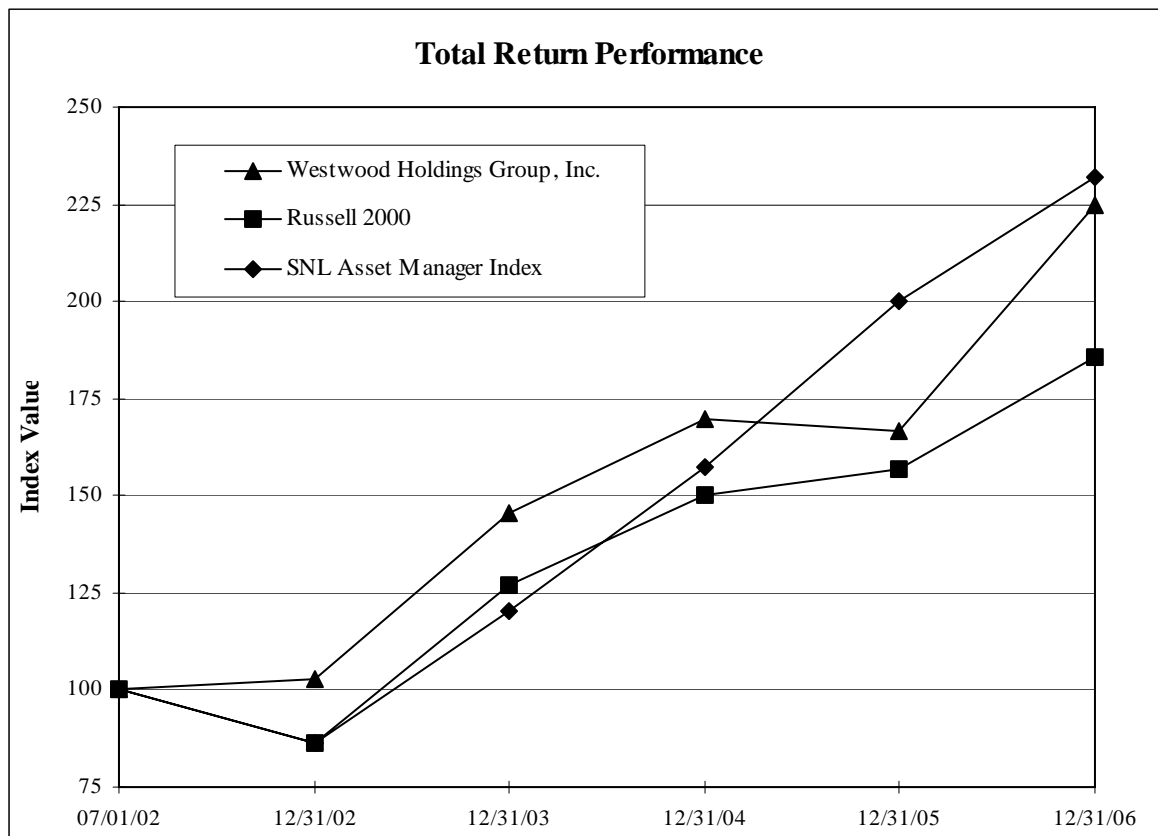
The following table gives information as of December 31, 2006 about shares of our common stock that may be issued upon the exercise of options, warrants and rights under the Third Amended and Restated Westwood Holdings Group, Inc. Stock Incentive Plan, our only equity compensation plan in effect at that time. The material terms of this plan were approved by our stockholders at our 2006 annual meeting.

Third Amended and Restated Westwood Holdings Group, Inc. Stock Incentive Plan	Number of securities to be issued upon exercise of outstanding options (a)	Weighted- average exercise price of outstanding options (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders .....	124,531	\$12.92	579,563
Equity compensation plans not approved by security holders .....	-	-	-
<b>Total.....</b>	<b>124,531</b>	<b>\$12.92</b>	<b>579,563</b>

## PERFORMANCE GRAPH

The following graph compares total stockholder returns of Westwood since July 1, 2002, the date we began trading as a public company after the spin-off, with the total return of the Russell 2000 Index and the SNL Asset Manager Index. The SNL Asset Manager Index is a composite of twenty-four publicly traded asset management companies.

**Comparison of Cumulative Total Return on Investment Since July 1, 2002**



<i>Index</i>	<b>Period ending</b>					
	<b>07/01/02</b>	<b>12/31/02</b>	<b>12/31/03</b>	<b>12/31/04</b>	<b>12/31/05</b>	<b>12/31/06</b>
Westwood Holdings Group, Inc.	100.00	102.66	145.75	169.87	166.54	225.00
Russell 2000 Index	100.00	86.21	126.95	150.22	157.06	185.91
SNL Asset Manager Index	100.00	86.40	120.47	157.18	199.90	231.82

The total return for our stock and for each index assumes \$100 invested on July 1, 2002 in our common stock, the Russell 2000 Index, and the SNL Asset Manager Index, including the reinvestment of dividends. Our common stock is traded on the NYSE.

The closing price of our common stock on the last trading day of the year ended December 31, 2006 was \$23.03 per share. Historical stock price performance is not necessarily indicative of future price performance.

**Item 6. Selected Consolidated Financial Data.**

**SELECTED CONSOLIDATED FINANCIAL DATA**

The selected consolidated financial data presented below for the five years ended December 31, 2006, except Assets Under Management, is derived from the consolidated financial statements as audited by Grant Thornton LLP, independent registered accounting firm for the year ended December 31, 2006, and from the consolidated financial statements as audited by Deloitte & Touche LLP, independent registered accounting firm for the years ended December 31, 2005, 2004, 2003 and 2002, and should be read in conjunction with those statements. The data below for a portion of the year ended December 31, 2002 reflects our results as it had historically been operated as a part of SWS. These results may not be indicative of our performance as an independent company. The information set forth below should be read in conjunction with "Item 1. Business" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Report.

	<b>Year ended December 31,</b>				
	<b>(in thousands, except per share amounts)</b>				
	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
<b>Consolidated Statements of Income Data:</b>					
Total revenues.....	\$27,364	\$21,940	\$19,980	\$20,078	\$21,624
Total expenses .....	20,110	15,897	13,995	12,198	12,960
Income before income taxes .....	7,254	6,043	5,985	7,880	8,664
Provision for income taxes .....	2,785	2,407	2,299	2,996	3,453
Income before cumulative effect of accounting change .....	4,469	3,636	3,686	4,884	5,211
Net income.....	4,508	3,636	3,686	4,884	5,211
Income before cumulative effect of change in accounting principle per share – basic (1).....	\$0.80	\$0.67	\$0.68	\$0.91	\$0.97
Income before cumulative effect of change in accounting principle per share – diluted (1).....	\$0.79	\$0.66	\$0.68	\$0.90	\$0.97
Earnings per share – basic (1).....	\$0.81	\$0.67	\$0.68	\$0.91	\$0.97
Earnings per share – diluted (1).....	\$0.79	\$0.66	\$0.68	\$0.90	\$0.97
Cash dividends declared per common share ...	\$1.33	\$1.09	\$0.99	\$1.18	\$0.04

	<b>As of December 31,</b>				
	<b>(in thousands)</b>				
	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
<b>Consolidated Balance Sheet Data:</b>					
Cash and investments .....	\$20,110	\$19,775	\$19,352	\$21,056	\$18,589
Total assets .....	28,722	27,310	26,277	26,237	24,120
Stockholders' equity .....	22,735	21,559	21,663	21,853	19,123
<b>Assets Under Management (in millions).....</b>	<b>\$5,927</b>	<b>\$4,928</b>	<b>\$3,996</b>	<b>\$3,954</b>	<b>\$4,078</b>

(1) Earnings per share figures reflect a 1,003.8-for-1 stock split in the form of a stock dividend effective as of June 21, 2002. All amounts have been restated to reflect the impact of this stock split.

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*You should read the following discussion and analysis in conjunction with "Selected Consolidated Financial Data" included in this Report, as well as our consolidated financial statements and related notes thereto appearing elsewhere in this Report.*

### *Forward-Looking Statements*

Statements in this Report and the Annual Report to Stockholders that are not purely historical facts, including statements about our expected future financial position, results of operations or cash flows, as well as other statements including words such as "anticipate," "believe," "plan," "estimate," "expect," "intend," "should," "could," "goal," "target," "designed," "on track," "comfortable with," "optimistic" and other similar expressions, constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Actual results and the timing of some events could differ materially from those projected in or contemplated by the forward-looking statements due to a number of factors, including, without limitation, those set forth below:

- our ability to identify and successfully market services that appeal to our customers;
- the significant concentration of our revenues in four of our customers;
- our relationships with investment consulting firms;
- our relationships with current and potential customers;
- our ability to retain qualified personnel;
- our ability to successfully develop and market new asset classes;
- our ability to maintain our fee structure in light of competitive fee pressures;
- competition in the marketplace;
- downturn in the financial markets;
- the passage of legislation adversely affecting the financial services industries;
- interest rates;
- changes in our effective tax rate;
- our ability to maintain an effective system of internal controls; and
- the other risks detailed from time to time in our SEC reports.

Additional factors that could cause our actual results to differ materially from our expectations are discussed under the section entitled "Risk Factors" and elsewhere in this Report. You should not unduly rely on these forward-looking statements, which speak only as of the date of this Report. Except as required by law, we are not obligated to publicly release any revisions to these forward-looking statements to reflect events or circumstances occurring after the date of this Report or to reflect the occurrence of unanticipated events.

### **Overview**

We manage investment assets and provide services for our clients through our two subsidiaries, Westwood Management and Westwood Trust. Westwood Management provides investment advisory services to corporate pension funds, public retirement plans, endowments and foundations, the WHG Funds, other mutual funds and clients of Westwood Trust. Westwood Trust provides to institutions and high net worth individuals trust and custodial services and participation in common trust funds that it sponsors. Our revenues are generally derived from fees based on a percentage of assets under management, and at December 31, 2006, Westwood Management and Westwood Trust collectively managed assets valued at approximately \$5.9 billion. We have been providing investment advisory services since 1983 and, according to recognized industry sources, including Morningstar, Inc., when measured over multi-year periods, our principal asset classes have consistently ranked above the median in performance within their peer groups.

One of the priorities on which we have focused since our spin-off in 2002 is building a foundation in terms of personnel and infrastructure to support a potentially much larger business. We have also developed products that we believe will be desirable within our target institutional and private client markets. The cost of developing new products and the organization as a whole has resulted in us incurring expenses that, in some cases, do not currently have material offsetting revenue. Now that we believe the foundation and the products are in place, we are taking these new products

to the institutional marketplace and believe that institutional investors will recognize the value in these products and generate new revenue streams for us.

We began marketing our SMidCap Value product to institutional investment consultants in late 2004. As a result of this targeted marketing effort, we gained a number of meaningful SMidCap Value clients in 2005 and 2006. We continue to devote significant marketing effort to our SMidCap Value product and intend to begin marketing our SmallCap Value product, which now has a three-year track record, to the institutional market during 2007. We also launched four mutual funds under the WHG Funds name from December 2005 to September 2006. As of December 31, 2006, assets in these four funds were approximately \$130 million. We have two additional WHG Funds that are registered with the SEC, the WHG SmallCap Value Fund and the WHG AllCap Value Fund, and are evaluating opportunities to launch these funds in 2007.

### *Revenues*

We derive our revenues from investment advisory fees, trust fees, and other revenues. Our advisory fees are generated by Westwood Management, which manages its clients' accounts under investment advisory and subadvisory agreements. Advisory fees are calculated based on a percentage of assets under management, and are paid in accordance with the terms of the agreements. Westwood Management's advisory fees are paid quarterly in advance based on the assets under management on the last day of the preceding quarter, quarterly in arrears based on the assets under management on the last day of the quarter just ended, or are based on a daily or monthly analysis of assets under management for the stated period. Westwood Management recognizes revenues as services are rendered. Since most of our advance paying clients' billing periods coincide with the calendar quarter to which payment relates, the revenue related to those clients is fully recognized within the quarter. Consequently, there is not a significant amount of deferred revenue contained in our financial statements.

Our trust fees are generated by Westwood Trust pursuant to trust or custodial agreements. Trust fees are separately negotiated with each client and are generally based on a percentage of assets under management, which in turn is influenced by the complexity of the operations of the trust and the services provided. Westwood Trust also provides trust services to a small number of clients on a fixed fee basis. Most trust fees are paid quarterly in advance and are recognized as services are rendered. Since the majority of Westwood Trusts' advance paying clients' billing periods coincide with the calendar quarter to which payment relates, the revenue related to those clients is fully recognized within the quarter. Consequently, there is not a significant amount of deferred revenue contained in our financial statements.

Our other revenues generally consist of interest and investment income. Although we invest most of our cash in money market funds, we also invest in bonds and equity instruments.

### *Assets Under Management*

Assets under management increased \$999 million, or 20.3%, to \$5.9 billion at December 31, 2006 compared to \$4.9 billion at December 31, 2005. The increase in assets under management was primarily due to the market appreciation of assets under management and inflows of assets from new clients, partially offset by the withdrawal of assets by certain clients. Quarterly average assets under management increased \$1.1 billion, or 25.0%, to \$5.5 billion for 2006 compared with \$4.4 billion for 2005.

Assets under management increased \$932 million, or 23.3%, to \$4.9 billion at December 31, 2005 compared to \$4.0 billion at December 31, 2004. The increase in assets under management was primarily due inflows of assets from new clients and the market appreciation of assets under management, partially offset by the withdrawal of assets by certain clients. Quarterly average assets under management increased \$477 million, or 12.2%, to \$4.4 billion for 2005 compared with \$3.9 billion for 2004.



	As of December 31, (1)			% Change	
	(in millions)			2006 vs. 2005	2005 vs. 2004
	2006	2005	2004		
<b>Westwood Management Corp.</b>					
Separate Accounts.....	\$2,578	\$2,357	\$1,853	9.4%	27.2%
Subadvisory.....	953	719	577	32.5	24.6
WHG Funds .....	130	8	-	1,525.0	-
Westwood Funds.....	374	373	372	0.3	0.3
Managed Accounts.....	315	225	169	40.0	33.1
Total.....	4,350	3,682	2,971	18.1	23.9
<b>Westwood Trust</b>					
Commingled Funds .....	1,229	990	856	24.1	15.7
Private Accounts .....	225	209	122	7.7	71.3
Agency/Custody Accounts.....	123	47	47	161.7	-
Total.....	1,577	1,246	1,025	26.6	21.6
<b>Total Assets Under Management.....</b>	<b>\$5,927</b>	<b>\$4,928</b>	<b>\$3,996</b>	<b>20.3%</b>	<b>23.3%</b>

(1) The above table excludes the SWS cash reserve funds for which Westwood Management serves as investment adviser and Westwood Trust serves as custodian. The SWS cash reserve funds were \$172 million, \$184 million and \$194 million as of December 31, 2006, 2005 and 2004, respectively. These accounts are noted separately due to their unique nature within our business and because they can experience significant fluctuations on a weekly basis.

*Westwood Management.* In the preceding table, "Separate Accounts" represent corporate pension and profit sharing plans, public employee retirement accounts, Taft Hartley plans, endowments, foundations and individuals. "Subadvisory" represents relationships where Westwood Management provides investment management services for funds offered by other financial institutions. "WHG Funds" represent the family of institutional mutual funds for which Westwood Management serves as advisor. "Westwood Funds" represent the family of mutual funds for which Westwood Management serves as subadvisor. "Managed Accounts" represent relationships with brokerage firms and other registered investment advisors who offer Westwood Management's products to their customers.

*Westwood Trust.* In the preceding table, "Commingled Funds" represent funds that have been established to facilitate investment of fiduciary funds of multiple clients by combining assets into a single trust for taxable and tax-exempt entities. "Private Accounts" represent discretionary accounts where Westwood Trust acts as trustee or agent and has full investment discretion. "Agency/Custody Accounts" represent non-discretionary accounts in which Westwood Trust provides agent or custodial services, but does not act in an advisory capacity. For certain assets in this category, Westwood Trust provides limited custody services for a minimal or zero fee currently, but views these assets as potentially converting to fee-generating managed assets in the future. As an example, some assets in this category consist of low-basis stock that is being held in custody for clients currently, but will likely transfer to fee-generating managed assets during an intergenerational transfer of wealth at some point in the future.

## Results of Operations

The following table and discussion of our results of operations is based upon data derived from the consolidated statements of income contained in our consolidated financial statements and should be read in conjunction with these statements, which are included elsewhere in this report.

	Years ended December 31, (in thousands)			% Change	
	2006	2005	2004	2006 vs. 2005	2005 vs. 2004
<b>Revenues</b>					
Advisory fees .....	\$17,532	\$13,868	\$13,069	26.4%	6.1%
Trust fees .....	8,240	7,031	5,818	17.2	20.8
Other revenues .....	1,592	1,041	1,093	52.9	(4.8)
Total revenues .....	27,364	21,940	19,980	24.7	9.8
<b>Expenses</b>					
Employee compensation and benefits..	14,920	11,566	9,799	29.0	18.0
Sales and marketing .....	528	443	473	19.1	(6.3)
WHG mutual funds .....	238	14	-	1600.0	-
Information technology .....	925	809	692	14.3	16.9
Professional services .....	1,373	1,194	1,248	15.0	(4.3)
General and administrative .....	2,126	1,871	1,783	13.6	4.9
Total expenses .....	20,110	15,897	13,995	26.5	13.6
Income before income taxes .....	7,254	6,043	5,985	20.0	1.0
Provision for income taxes .....	2,785	2,407	2,299	15.7	4.7
Income before cumulative effect of accounting change .....	4,469	3,636	3,686	22.9	(1.4)
Cumulative effect of change in accounting principle, net of tax .....	39	-	-	-	-
<b>Net income</b> .....	<u>\$ 4,508</u>	<u>\$ 3,636</u>	<u>\$ 3,686</u>	<u>24.0%</u>	<u>(1.4)%</u>

### Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

**Total Revenue.** Our total revenues increased by 24.7% to \$27.4 million in 2006 compared with \$21.9 million in 2005. Advisory fees increased by 26.4% to \$17.5 million in 2006 from \$13.9 million in 2005 primarily due to growth in assets under management of existing clients due to market appreciation as well as inflows from new clients added in 2006. These increases were partially offset by the withdrawal of assets by certain clients. Trust fees increased by 17.2% to \$8.2 million in 2006 from \$7.0 million in 2005 primarily due to inflows from new clients added in 2006 as well as growth in assets under management of existing clients due to market appreciation. These increases were partially offset by the withdrawal of assets by certain clients. Other revenues, which generally consist of interest and investment income, increased by 52.9% to \$1.6 million in 2006 compared with \$1.0 million in 2005. Other revenues increased primarily due to increases of \$554,000 in interest and dividend income, \$150,000 in realized gains and \$79,000 in unrealized gains. These increases were partially offset by a decrease of \$231,000 in consulting revenue from Gabelli Advisers, which was due to the termination of our consulting fee arrangement. We were notified by Gabelli Advisers in the fourth quarter 2006 that our consulting payment arrangement was to be replaced with a dividend payment from Gabelli Advisers, which is included in dividend income. The amount of the dividend was approximately \$50,000 less than the amount of consulting payments that had been accrued up to that point.

**Employee Compensation and Benefits.** Employee compensation and benefits, which generally consist of salaries, incentive compensation, equity based compensation expense and benefits, increased by 29.0% to \$14.9 million compared with \$11.6 million in 2005. This increase resulted primarily from an increase of approximately \$2.4 million in restricted stock expense due to additional restricted stock grants in July 2006, May 2006 and July 2005, increased salary expense of \$726,000 due to increased headcount and salary increases for certain employees, increased incentive compensation expense of \$207,000, increased payroll taxes related to the increases in salary and incentive

compensation expense and the payment of dividends on unvested restricted stock, increased employee health insurance expense and increased 401(k) and profit sharing contributions. A decrease of \$124,000 in compensation expense related to stock options partially offset these increases. We had 48 full-time employees as of December 31, 2006 compared to 47 at December 31, 2005.

*Sales and Marketing.* Sales and marketing costs consist of expenses associated with our marketing efforts, including travel and entertainment, direct and consultant marketing and advertising costs. Sales and marketing costs increased by 19.1% to \$528,000 in 2006 compared with \$443,000 in 2005. The increase is primarily the result of increases in direct marketing expense of \$40,000 and in travel and entertainment costs of \$47,000.

*WHG Mutual Funds.* WHG Mutual Funds expenses generally consist of costs associated with our marketing, distribution and administration efforts related to the WHG Funds. WHG mutual funds expenses were \$238,000 in 2006 compared with \$14,000 in 2005. This substantial increase is due to the launch of the funds in the fourth quarter of 2005 and the second and third quarters of 2006. Currently, the largest component of these costs is fund expense reimbursements reflecting our partial subsidy of mutual fund expenses, as we have capped the expense ratios for the funds in order to competitively position them in institutional and defined contribution markets.

*Information Technology.* Information technology expenses are generally costs associated with proprietary investment research tools, computing hardware, software licenses, maintenance and support, telecommunications and other related costs. Information technology expense increased by 14.3% to \$925,000 in 2006 compared with \$809,000 in 2005. The increase is primarily due to increases of \$61,000 in costs related to the addition of a new performance measurement tool for Westwood Trust clients and other application enhancements, \$35,000 in IT environment support costs and \$16,000 in costs related to the upgrade of a critical application. These increases were partially offset by decreases in website maintenance costs, equipment rental costs and computer hardware depreciation expense.

*Professional Services.* Professional services expenses generally consist of audit, external subadvisor expense, legal and other professional fees. Professional services expense increased by 15.0% to \$1.4 million in 2006 compared with \$1.2 million in 2005. The increase is primarily due to a \$196,000 increase in advisory fees paid to external subadvisors due to increased assets under management in international equity and growth common trust funds sponsored by Westwood Trust and a \$68,000 increase in legal fees. Partially offsetting these increases was a decrease of \$81,000 in external audit and Sarbanes-Oxley costs resulting from our change in external auditors for the fiscal year 2006.

*General and Administrative.* General and administrative expenses generally consist of costs associated with the lease of our office space, insurance, office supplies, custody expense, investor relations, charitable contributions and other miscellaneous expenses. General and administrative expenses increased by 13.6% to \$2.1 million in 2006 compared with \$1.9 million in 2005. The increase is primarily due to increases of \$82,000 in the fees paid to our independent directors, \$50,000 in charitable contributions, \$50,000 from the write-off of uncollectible receivables due to the termination of the Gabelli Advisers consulting fee arrangement and \$24,000 in occupancy costs.

*Provision for Income Taxes.* Provision for income taxes increased by 15.7% to \$2.8 million in 2006 compared with \$2.4 million in 2005 primarily due to higher income before taxes. The effective tax rate was 38.4% in 2006 compared to 39.8% in 2005. The effective tax rate in 2006 is lower than 2005 because \$135,000 of restricted stock expense in 2005 was not deductible for tax purposes due to the grant price exceeding the market price on the date of vest.

*Cumulative Effect of a Change in Accounting Principle, Net of Tax.* In December 2004, the FASB revised Statement of Financial Accounting Standards No. 123 (“SFAS No. 123 (R)”), requiring public companies to recognize the cost resulting from all share-based payment transactions in their financial statements. We applied the fair value provisions of the original SFAS No. 123 for all options and restricted shares we issued and accounted for forfeitures as they occurred. Under SFAS No. 123 (R) we are required to estimate the effect of forfeitures. As a result, on January 1, 2006 we recorded a cumulative effect of a change in accounting principle totaling \$39,000, net of tax, in order to reverse compensation expense recorded for unvested securities as of December 31, 2005 that is in excess of what we estimate will vest.

*Year Ended December 31, 2005 Compared to Year Ended December 31, 2004*

*Total Revenue.* Our total revenues increased by 9.8% to \$21.9 million in 2005 compared with \$20.0 million in 2004. Advisory fees increased by 6.1% to \$13.9 million in 2005 from \$13.1 million in 2004 primarily due to new clients added in 2005 and growth in assets under management of existing clients due to market appreciation. These increases were partially offset by the withdrawal of assets by certain clients. Trust fees increased by 20.8% to \$7.0 million in 2005 from \$5.8 million in 2004 primarily due to new clients added in 2005 and growth in assets under management of existing clients due to market appreciation. These increases were partially offset by the withdrawal of assets by certain clients. Other revenues, which generally consist of interest and investment income and consulting fees, decreased by 4.8% to \$1.0 million in 2005 compared with \$1.1 million in 2004. Other revenues decreased primarily due to decreased realized gains of \$242,000, a reduction in consulting revenue of \$48,000 due to decreased average assets under management in the Westwood Funds as well as increased expenses related to the administration of the Westwood Funds by Gabelli Advisers, Inc. These decreases were partially offset by increases of \$229,000 in interest and dividend income due to higher interest rates earned on investments.

*Employee Compensation and Benefits.* Employee compensation and benefits increased by 18.0% to \$11.6 million compared with \$9.8 million in 2004. This increase was due primarily to increases of \$864,000 in restricted stock expense related to a full year of amortization of the 2004 grant and six months of amortization of the 2005 grant in 2005 compared to six months of amortization of the 2004 grant in the prior year, \$505,000 in incentive compensation expense in 2005 compared to 2004, \$287,000 in salary expense due to increased headcount and salary increases, \$79,000 in 401(k) match expense due to an increase in our match rate from 4% in 2004 to 6% in 2005, \$66,000 in health insurance expense primarily due to increased premiums and \$40,000 in profit sharing expense due to an increased compensation base. These increases were partially offset by a decrease of \$117,000 in deferred compensation expense due to the termination of our deferred compensation plan in 2004. At December 31, 2005 we had 47 full-time employees compared to 45 at December 31, 2004.

*Sales and Marketing.* Sales and marketing costs decreased by 6.3% to \$443,000 in 2005 compared with \$473,000 in 2004. The decrease is primarily the result of decreases in direct marketing expense of \$23,000 and advertising costs of \$19,000. An increase of \$8,000 in travel and entertainment costs partially offset the decreases.

*WHG Mutual Funds.* WHG mutual funds expense was \$14,000 in 2005 while no expense was incurred in 2004. The 2005 expense consisted of mutual fund expense reimbursements resulting from the launch of two mutual funds in the fourth quarter of 2005.

*Information Technology.* Information technology expense increased by 16.9% to \$809,000 in 2005 compared with \$692,000 in 2004. The increase is primarily due to increases of \$58,000 in support costs, \$52,000 in costs related to the implementation of new customer relationship management and email archiving systems, \$28,000 in computer hardware depreciation expense and \$10,000 in website maintenance costs. These increases were partially offset by decreases of \$23,000 in equipment rental costs and \$9,000 in costs associated with investment research tools.

*Professional Services.* Professional services expense decreased by 4.3% to \$1.2 million in 2005. The decrease is primarily due to a \$134,000 decrease in professional fees primarily related to lower Sarbanes-Oxley compliance costs, a decrease in other professional fees of \$71,000 and a decrease in legal fees of \$66,000. Partially offsetting these decreases was an increase of \$166,000 in advisory fees paid to external subadvisors due to increased assets under management in international equity and growth common trust funds sponsored by Westwood Trust, as well as the engagement of a subadvisor in the second quarter of 2004 to manage growth portfolios at Westwood Trust and an increase of \$60,000 in external audit expense.

*General and Administrative.* General and administrative expenses increased by 4.9% to \$1.9 million in 2005 compared with \$1.8 million in 2004. The increase is primarily due to increases of \$58,000 in occupancy costs due to the new office space we moved into in mid 2004, \$53,000 in depreciation due to office furnishings purchased in mid 2004, \$19,000 in custody expense due to increased assets under management at Westwood Trust, \$16,000 in property taxes due to the new office space and furnishings and \$11,000 in director's fees primarily due to an increase in the

number of outside directors. These increases were partially offset by decreases of \$60,000 in stationery and printing costs, office supplies and other costs incurred in 2004 associated with moving and furnishing our corporate office and \$41,000 in other administrative expenses.

*Provision for Income Taxes.* Provision for income taxes increased by 4.7% to \$2.4 million in 2005 compared with \$2.3 million in 2004 primarily due to higher income before taxes. The effective tax rate was 39.8% in 2005 compared to 38.4% in 2004. The increase in the effective tax rate in 2005 was due primarily to a decrease in the deduction for restricted stock that vested in 2005, which was driven by the market price on the vesting date being lower than the price on the grant date.

## Supplemental Financial Information

As supplemental information, we are providing non-GAAP performance measures that we refer to as cash earnings and cash expenses. We provide these measures in addition to, but not as a substitute for, net income and total expenses, which are reported on a GAAP basis. Both our Management and Board of Directors review cash earnings and cash expenses to evaluate our ongoing performance, allocate resources and review dividend policy. We believe that these non-GAAP performance measures, while not substitutes for GAAP net income and total expenses, are useful for both management and investors to evaluate our underlying operating and financial performance and our available resources. We do not advocate that investors consider these non-GAAP measures without considering financial information prepared in accordance with GAAP.

In calculating cash earnings, we add to net income the non-cash expense associated with equity-based compensation awards of restricted stock and stock options. In calculating cash earnings for the year ended December 31, 2006, we also eliminate the non-cash cumulative effect of change in accounting principle associated with our implementation of SFAS No.123 (R). We define cash expenses as total expenses less non-cash equity-based compensation expense. Although depreciation on fixed assets is a non-cash expense, we do not add it back when calculating cash earnings or deduct it when calculating cash expenses because depreciation charges represent a decline in the value of the related assets that will ultimately require replacement.

For the year ended December 31, 2006, our cash earnings increased by 51.6% to \$9.1 million compared with \$6.0 million for the year ended December 31, 2005, primarily due to a 24.7% increase in total revenues.

The following table provides a reconciliation of net income to cash earnings and total expenses to cash expenses for the years presented:

	2006	2005	2004	% Change	
				2006 vs. 2005	2005 vs. 2004
GAAP Net Income.....	\$4,508,000	\$3,636,000	\$3,686,000	24.0%	(1.4)%
Add: Restricted stock expense.....	4,500,000	2,114,000	1,250,000	112.9	69.1
Add: Stock option expense.....	126,000	250,000	249,000	(49.6)	0.4
Less: Cumulative effect of change in accounting principle.....	(39,000)	-	-	-	-
Non-GAAP cash earnings.....	<u>\$9,095,000</u>	<u>\$6,000,000</u>	<u>\$5,185,000</u>	<u>51.6</u>	<u>15.7</u>
Total GAAP expenses.....	\$20,110,000	\$15,897,000	\$13,995,000	26.5	13.6
Less: Restricted stock expense.....	(4,500,000)	(2,114,000)	(1,250,000)	112.9	69.1
Less: Stock option expense.....	(126,000)	(250,000)	(249,000)	(49.6)	0.4
Cash expenses.....	<u>\$15,484,000</u>	<u>\$13,533,000</u>	<u>\$12,496,000</u>	<u>14.4</u>	<u>8.3</u>

## Liquidity and Capital Resources

Historically, we have funded our operations and cash requirements with cash generated from operating activities. As of December 31, 2006, we had no long-term debt. The changes in net cash provided by operating

activities generally reflect the changes in earnings plus the effect of non-cash items and changes in working capital. Changes in working capital, especially accounts receivable and accounts payable, are generally the result of timing differences between collection of fees billed and payment of operating expenses.

During 2006, cash flow provided by operating activities, principally our investment advisory business, was \$7.2 million compared to \$6.3 million and \$2.4 million during 2005 and 2004, respectively. The increase of \$940,000 from 2005 to 2006 was primarily due to increased cash earnings, offset in part by the net change in operating assets and liabilities. The increase of \$3.8 million from 2004 to 2005 was primarily due to a decrease in the net purchases of trading securities, increased cash earnings and the net change in operating assets and liabilities. At December 31, 2006 and 2005, we had working capital of \$19.7 million and \$18.3 million, respectively.

Cash flow provided by investing activities during 2006 was \$0.9 million, and was primarily related to net sales of available-for-sale investments. Cash provided by investing activities during 2005 of \$1.0 million was primarily related to net sales of available-for-sale investments and cash used in investing activities during 2004 of \$112,000 was primarily related to the build-out and furnishing of the Company's new office space, offset in part by net purchases of available-for-sale investments.

Cash used in financing activities during 2006 of \$7.9 million was primarily related to the payment of cash dividends on our common stock of \$8.3 million, offset by \$402,000 in proceeds received from stock option exercises. Cash used in financing activities during 2005 and 2004 was \$6.1 million and \$5.2 million, respectively, and was primarily related to the payment of cash dividends on our common stock.

We had cash and investments of \$20.1 million and \$19.8 million at December 31, 2006 and December 31, 2005, respectively. As required by the Texas Finance Code, Westwood Trust maintains minimum restricted capital of \$1.0 million, which is included in Investments in the accompanying consolidated balance sheets. We had no liabilities for borrowed money at December 31, 2006 or December 31, 2005, and our accounts payable were paid in the ordinary course of business for each of the periods then ended.

Our future liquidity and capital requirements will depend upon numerous factors including our results of operations, the timing and magnitude of capital expenditures or strategic initiatives and our dividend policy. We believe that current cash and short-term investment balances and cash generated from operations will be sufficient to meet the operating and capital requirements of our ordinary business operations through at least the next twelve months. However, there can be no assurance that we will not require additional financing within this time frame. The failure to raise needed capital on attractive terms, if at all, could have a material adverse effect on our business, financial condition and results of operations.

### ***Contractual Obligations***

The following table summarizes our contractual obligations as of December 31, 2006 (in thousands).

<u>Contractual Obligations</u>	<u>Payments due in:</u>			
	<u>Total</u>	<u>Less than 1 year</u>	<u>1-3 years</u>	<u>3-5 years</u>
Non-cancelable operating leases	\$2,869	\$626	\$1,292	\$951

### ***Accounting Developments***

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48 (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes". FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. We have evaluated our tax positions in the tax returns we have filed, as well as unfiled tax positions and the amounts

comprising our deferred tax assets and determined that FIN 48 will not have a material impact on our financial statements.

In September 2006, the FASB issued FASB Statement No. 157, Fair Value Measurements (“FAS 157”), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles. The provisions of FAS 157 are effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently evaluating the potential impact of the adoption of FAS 157.

In September 2006, the Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (“SAB 108”). SAB 108 was issued to provide consistency between how registrants quantify financial statement misstatements. SAB 108 established an approach that requires dual quantification of financial statement misstatements based on the effects of the misstatement on the income statement, balance sheet and other disclosures. It is referred to as the “dual” approach as it combines two widely used approaches, which focused on either the income statement or the balance sheet. SAB 108 removes the singular focus on either of those financial statements and the lingering errors that could potentially result. SAB 108 allows registrants to initially apply the dual approach either by (1) retroactively adjusting prior financial statements as if the dual approach had always been used or by (2) recording the cumulative effect of initially applying the dual approach as adjustments to the carrying values of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained earnings. SAB 108 is effective for fiscal years ending after November 15, 2006, and was adopted by us on December 31, 2006. The adoption of SAB 108 had no effect on our financial statements.

### ***Critical Accounting Policies and Estimates***

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent losses and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. In applying accounting principles, we must often make individual estimates and assumptions regarding expected outcomes or uncertainties. Our estimates, judgments and assumptions are continually evaluated based on available information and experience. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates. We believe the following are areas where the degree of judgment and complexity in determining amounts recorded in our consolidated financial statements make the accounting policies critical.

#### *Goodwill*

During the third quarters of 2006, 2005 and 2004, we completed our annual impairment assessment as required by SFAS 142 “Goodwill and Other Intangible Assets”. No impairment losses were required. We perform our annual impairment assessment as of July 1.

#### *Stock Options*

For all options granted after January 1, 2002, we have been expensing the cost associated with employees as well as non-employee directors. We value stock options issued based upon the Black-Scholes option-pricing model and recognize this value as an expense over the periods in which the options vest. Implementation of the Black-Scholes option-pricing model requires us to make certain assumptions, including expected volatility, risk-free interest rate, expected dividend yield and expected life of the options. We utilized assumptions that we believed to be most appropriate at the time of the valuation. Had we used different assumptions in the pricing model the expense recognized for stock options may have been different than the expense recognized in our financial statements. As of December 31, 2006, all outstanding options have vested and all related compensation has been expensed.

### *Restricted Stock*

We have granted restricted stock to employees and non-employee directors. In accordance with FASB Statement of Financial Accounting Standards No. 123 Revised, we calculate compensation cost for restricted stock grants by using the fair market value of its common stock at the date of grant, the number of shares issued and an estimate of shares that will not vest due to forfeitures. This compensation cost is amortized on a straight-line basis over the applicable vesting period. The estimate of shares that will not vest due to forfeitures is based on our historical forfeiture rate and our expectation of potential forfeitures, which is dependent upon our judgment. If actual experience differs significantly from these estimates, stock based compensation expense and our results of operations could be materially affected.

### ***Significant Accounting Policies***

Our significant accounting policies are summarized below.

#### *Revenue Recognition*

Investment advisory and trust fees are recognized in the period the services are provided. These fees are determined in accordance with contracts between our subsidiaries and their clients and are generally based on a percentage of assets under management.

#### *Accounting for Investments*

We have designated our investments other than money market holdings as “trading” securities, which are recorded at market value with the related unrealized gains and losses reflected in “Other revenues” in the consolidated statements of income. Our “trading” securities, primarily U.S. Government and Government agency obligations as well as mutual fund and common trust fund shares, are valued based upon quoted market prices and, with respect to funds, the net asset value of the shares held as reported by the fund. We have generally designated our investments in money market accounts as “available for sale.” The market values of our money market holdings generally do not fluctuate. Dividends and interest on all of our investments are accrued as earned.

### **Item 7A. Quantitative and Qualitative Disclosures about Market Risk.**

We utilize various financial instruments such as equity mutual funds and U.S. government and agency obligations, which entail certain inherent market risks. We do not currently participate in any hedging activities, nor do we currently utilize any derivative financial instruments. The following information describes the key aspects of certain financial instruments that have market risks.

#### *Interest Rates and Securities Markets*

Our cash equivalents and other investment instruments are exposed to financial market risk due to fluctuations in interest rates, which may affect our interest income. These instruments are not entered into for trading purposes. We do not expect our interest income to be significantly affected by a sudden change in market interest rates.

The value of our assets under management is affected by changes in interest rates and fluctuations in securities markets. Since we derive a substantial portion of our revenues from investment advisory and trust fees based on the value of assets under management, our revenues may be adversely affected by changing interest rates or a decline in the prices of securities generally.

### **Item 8. Financial Statements and Supplementary Data.**

The independent registered public accounting firm’s reports and financial statements listed in the accompanying index are included in Item 15 of this report. See Index to Financial Statements on page F-1.



**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

Not applicable.

**Item 9A. Controls and Procedures.**

Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this annual report. Based on this evaluation, our management, including our Chief Executive Officer and our Chief Financial Officer, concluded that, as of December 31, 2006, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

Please refer to Westwood Holdings Group, Inc.'s Management Assessment of Internal Control over Financial Reporting on page F-5 of this Report.

Our independent registered public accounting firm has issued an audit report on (1) our management's assessment of the effectiveness of our internal control over financial reporting and (2) the effectiveness of our internal control over financial reporting. This report can be found on page F-4.

For the quarter ended December 31, 2006, there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information.**

Not applicable.

**PART III****Item 10. Directors and Executive Officers of the Company.**

The information required by this item is or will be set forth in the definitive proxy statement relating to the 2007 Annual Meeting of Stockholders of Westwood Holdings Group, Inc., which is to be filed with the Securities and Exchange Commission pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "Proxy Statement"). This definitive proxy statement relates to a meeting of stockholders involving the election of directors and the portions therefrom required to be set forth in this Form 10-K by this item are incorporated herein by reference pursuant to General Instruction G(3) to Form 10-K.

**Item 11. Executive Compensation.**

The information required by this item is or will be set forth in the Proxy Statement. This definitive proxy statement relates to a meeting of stockholders involving the election of directors and the portions therefrom required to be set forth in this Form 10-K by this item are incorporated herein by reference pursuant to General Instruction G(3) to Form 10-K.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information required by this item is or will be set forth in the Proxy Statement. This definitive proxy statement relates to a meeting of stockholders involving the election of directors and the portions therefrom required to

be set forth in this Form 10-K by this item are incorporated herein by reference pursuant to General Instruction G(3) to Form 10-K.

**Item 13. Certain Relationships and Related Transactions.**

The information required by this item is or will be set forth in the Proxy Statement. This definitive proxy statement relates to a meeting of stockholders involving the election of directors and the portions therefrom required to be set forth in this Form 10-K by this item are incorporated herein by reference pursuant to General Instruction G(3) to Form 10-K.

**Item 14. Principal Accountant Fees and Services.**

The information required by this item is or will be set forth in the Proxy Statement. This definitive proxy statement relates to a meeting of stockholders involving the election of directors and the portions therefrom required to be set forth in this Form 10-K by this item are incorporated herein by reference pursuant to General Instruction G(3) to Form 10-K.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules.**

**Financial Statement Schedules**

The financial statements included in this Report are listed in the Index to Financial Statements on page F-1 of this Report. Schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are either not required under the related instructions or inapplicable.

**Exhibits**

The exhibits required to be furnished pursuant to Item 15 are listed in the Exhibit Index filed herewith, which Exhibit Index is incorporated herein by reference.

## POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS that each of Westwood Holdings Group, Inc., a Delaware corporation, and the undersigned directors and officers of Westwood Holdings Group, Inc. hereby constitutes and appoints Brian O. Casey and William R. Hardcastle, Jr., or any one of them, its, his or her true and lawful attorney-in-fact and agent, for it, him or her and in its, his or her name, place and stead, in any and all capacities, with full power to act alone, to sign any and all amendments to this Report, and to file each such amendment to the Report, with all exhibits thereto, and any and all other documents in connection therewith, with the Securities and Exchange Commission, hereby granting unto said attorney-in-fact and agent full power and authority to do and perform any and all acts and things requisite and necessary to be done in and about the premises as fully to all intents and purposes as it, he or she might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent may lawfully do or cause to be done by virtue hereof.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WESTWOOD HOLDINGS GROUP, INC.

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

Dated: February 22, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signatures</u>	<u>Title</u>
<u>          /s/ Brian O. Casey          </u> Brian O. Casey	Chief Executive Officer and President (Principal Executive Officer)
<u>          /s/ William R. Hardcastle, Jr.          </u> William R. Hardcastle, Jr.	Chief Financial Officer (Principal Financial Officer)
<u>          /s/ Craig Whitten          </u> Craig Whitten	Controller (Principal Accounting Officer)
<u>          /s/ Susan M. Byrne          </u> Susan M. Byrne	Chairman of the Board of Directors and Chief Investment Officer
<u>          /s/ Tom C. Davis          </u> Tom C. Davis	Director

/s/ Frederick R. Meyer Director  
Frederick R. Meyer

/s/ Jon L. Mosle, Jr. Director  
Jon L. Mosle, Jr.

/s/ Richard M. Frank Director  
Richard M. Frank

/s/ Raymond E. Wooldridge Director  
Raymond E. Wooldridge

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Westwood Holdings Group, Inc.:

We have audited the accompanying consolidated balance sheet of Westwood Holdings Group, Inc. (a Delaware corporation) and subsidiaries (the "Company") as of December 31, 2006, and the related consolidated statements of income, stockholders' equity, and cash flows for the year ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Westwood Holdings Group, Inc. and subsidiaries as of December 31, 2006, and the results of their operations and their cash flows for the year ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(revised 2004) – "Share-Based Payment".

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 22, 2007 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Grant Thornton  
February 22, 2007  
Dallas, Texas

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Westwood Holdings Group, Inc.:

We have audited the accompanying consolidated balance sheet of Westwood Holdings Group, Inc. and subsidiaries (the "Company") as of December 31, 2005, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Westwood Holdings Group, Inc. and subsidiaries as of December 31, 2005 and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP  
Dallas, Texas  
February 22, 2006

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Westwood Holdings Group, Inc.:

We have audited management's assessment, included in the accompanying Report of Westwood Holdings Group, Inc.'s Management Assessment of Internal Control over Financial Reporting, that Westwood Holdings Group, Inc. (a Delaware corporation) and subsidiaries (the "Company") maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's 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. Also, 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.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of the Company as of December 31, 2006, and the related consolidated statements of income, stockholder's equity and cash flows for the year ended December 31, 2006, and our report dated February 22, 2007 expressed an unqualified opinion on those financial statements.

/s/ Grant Thornton  
February 22, 2007  
Dallas, Texas



**REPORT OF WESTWOOD HOLDINGS GROUP, INC.'S MANAGEMENT ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING**

To the Board of Directors and Stockholders of  
Westwood Holdings Group, Inc.:

The management of Westwood Holdings Group, Inc. ("Westwood") is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)). Westwood's internal control system was designed to provide reasonable assurance to the company's management and board of directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The management of Westwood assessed the effectiveness of Westwood's internal control over financial reporting as of December 31, 2006. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework*. Based on our assessment, we believe that, as of December 31, 2006, Westwood's internal control over financial reporting is effective based on those criteria.

Westwood's independent registered public accounting firm has issued an audit report on our assessment of Westwood's internal control over financial reporting. This report appears on page F-4.

By: /s/ Brian O. Casey  
Brian O. Casey, Chief Executive Officer

/s/ William R. Hardcastle, Jr.  
William R. Hardcastle, Jr., Chief Financial Officer

February 22, 2007  
Dallas, Texas

**WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

**As of December 31, 2006 and 2005**

**(in thousands, except par values and share amounts)**

<b>ASSETS</b>	<b>2006</b>	<b>2005</b>
<b>Current Assets:</b>		
Cash and cash equivalents .....	\$ 2,177	\$ 1,897
Accounts receivable .....	3,111	2,452
Investments, at market value .....	17,933	17,878
Deferred income taxes .....	1,267	573
Other current assets .....	465	410
Total current assets .....	24,953	23,210
Goodwill .....	2,302	2,302
Deferred income taxes .....	214	244
Property and equipment, net of accumulated depreciation of \$774 and \$523 .....	1,253	1,554
Total assets .....	\$28,722	\$27,310
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current Liabilities:</b>		
Accounts payable and accrued liabilities .....	\$ 778	\$ 715
Dividends payable .....	996	539
Compensation and benefits payable .....	2,801	2,980
Income taxes payable .....	689	694
Other current liabilities .....	10	7
Total current liabilities .....	5,274	4,935
Deferred rent .....	713	816
Total liabilities .....	5,987	5,751
<b>Stockholders' Equity:</b>		
Common stock, \$0.01 par value, authorized 10,000,000 shares, issued and outstanding 6,638,525 shares at December 31, 2006; issued and outstanding 5,986,647 shares at December 31, 2005 .....	66	60
Additional paid-in capital .....	20,289	21,459
Unamortized stock compensation .....	-	(6,572)
Retained earnings .....	2,380	6,612
Total stockholders' equity .....	22,735	21,559
Total liabilities and stockholders' equity .....	\$28,722	\$27,310

See notes to consolidated financial statements.

**WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME**  
**For the Years Ended December 31, 2006, 2005 and 2004**  
**(in thousands, except per share data)**

	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>REVENUES:</b>			
Advisory fees .....	\$17,532	\$13,868	\$13,069
Trust fees .....	8,240	7,031	5,818
Other revenues .....	1,592	1,041	1,093
Total revenues .....	27,364	21,940	19,980
<b>EXPENSES:</b>			
Employee compensation and benefits .....	14,920	11,566	9,799
Sales and marketing .....	528	443	473
WHG mutual funds .....	238	14	-
Information technology .....	925	809	692
Professional services .....	1,373	1,194	1,248
General and administrative .....	2,126	1,871	1,783
Total expenses .....	20,110	15,897	13,995
Income before income taxes .....	7,254	6,043	5,985
Provision for income taxes .....	2,785	2,407	2,299
Income before cumulative effect of change in accounting principle .....	4,469	3,636	3,686
Cumulative effect of change in accounting principle, net of income taxes of \$21 .....	39	-	-
Net income .....	\$ 4,508	\$ 3,636	\$ 3,686
<b>Earnings per share:</b>			
<b>Basic:</b>			
Continuing operations .....	\$0.80	\$0.67	\$0.68
Cumulative effect of a change in accounting principle .....	0.01	-	-
Net income .....	\$0.81	\$0.67	\$0.68
<b>Diluted:</b>			
Continuing operations .....	\$0.79	\$0.66	\$0.68
Cumulative effect of a change in accounting principle .....	0.00	-	-
Net income .....	\$0.79	\$0.66	\$0.68

See notes to consolidated financial statements.

**WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**

**For the Years Ended December 31, 2006, 2005 and 2004**

**(in thousands, except share and per share data)**

	Westwood Holdings Group, Inc.		Addi- tional Paid-In Capital	Treasury Stock	Unamort- ized Stock Compen- sation	Retained Earnings	Total
	Common Stock, Par Shares	Amount					
BALANCE, January 1, 2004.....	5,550,119	\$56	\$12,952	\$(6)	\$(2,609)	\$11,460	\$21,853
Net income .....						3,686	3,686
Sale of treasury stock – 353 shares.....	353	-		6			6
Issuance of restricted stock .....	192,500	2	3,460		(3,462)		-
Amortization of stock compensation...					1,250		1,250
Tax benefit related to equity compensation .....			157				157
Dividends declared (\$0.99 per share) ..						(5,682)	(5,682)
Stock options vested .....			249				249
Stock options exercised .....	11,175	-	144				144
BALANCE, December 31, 2004.....	5,754,147	\$58	\$16,962	\$ -	\$(4,821)	\$ 9,464	\$21,663
Net income .....						3,636	3,636
Issuance of restricted stock .....	211,500	2	3,863		(3,865)		-
Amortization of stock compensation...					2,114		2,114
Tax benefit related to equity compensation .....			113				113
Dividends declared (\$1.09 per share) ..						(6,488)	(6,488)
Stock options vested .....			250				250
Stock options exercised .....	21,000	-	271				271
BALANCE, December 31, 2005.....	5,986,647	\$60	\$21,459	\$ -	\$(6,572)	\$ 6,612	\$21,559
Net income .....						4,508	4,508
Issuance of restricted stock .....	620,784	6	(6)				-
Reversal of unamortized stock compensation due to FAS 123 (R) implementation .....			(6,572)		6,572		-
Amortization of stock compensation...			4,500				4,500
Tax benefit related to equity compensation .....			440				440
Dividends declared (\$1.33 per share) ..						(8,740)	(8,740)
Stock options vested .....			126				126
Stock options exercised .....	31,094	-	402				402
Cumulative effect of change in accounting principle.....			(60)				(60)
BALANCE, December 31, 2006.....	6,638,525	\$66	\$20,289	\$ -	\$ -	\$ 2,380	\$22,735

See notes to consolidated financial statements.

**WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Years Ended December 31, 2006, 2005 and 2004**  
(in thousands)

	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income .....	\$ 4,508	\$ 3,636	\$ 3,686
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization.....	266	272	191
Loss on sale of other assets .....	-	-	4
Unrealized gains on investments .....	(143)	(64)	(21)
Stock option expense .....	126	250	249
Restricted stock amortization.....	4,500	2,114	1,250
Deferred income taxes .....	(685)	(300)	(153)
Cumulative effect of change in accounting principle.....	(39)	-	-
Excess tax benefits from stock based compensation.....	(30)	-	-
Net purchases of investments – trading securities.....	(889)	(288)	(2,248)
Change in operating assets and liabilities:			
Accounts receivable .....	(659)	(620)	99
Other assets.....	(58)	(18)	(7)
Accounts payable and accrued liabilities.....	63	86	(307)
Compensation and benefits payable .....	(179)	277	(73)
Income taxes payable and prepaid taxes.....	435	830	(338)
Other liabilities .....	8	109	95
Net cash provided by operating activities .....	7,224	6,284	2,427
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchases of money market funds – available for sale.....	(7,869)	(4,863)	(21,755)
Sales of money market funds – available for sale.....	8,846	5,969	22,805
Purchase of property and equipment .....	(70)	(75)	(1,189)
Sale of property and equipment.....	-	-	27
Net cash provided by (used in) investing activities.....	907	1,031	(112)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Sale of treasury stock.....	-	-	6
Excess tax benefits from stock based compensation .....	30	-	-
Proceeds from exercise of stock options .....	402	271	144
Cash dividends.....	(8,283)	(6,409)	(5,388)
Net cash used in financing activities .....	(7,851)	(6,138)	(5,238)
<b>NET INCREASE (DECREASE) IN CASH.....</b>	<b>280</b>	<b>1,177</b>	<b>(2,923)</b>
Cash, beginning of year.....	1,897	720	3,643
Cash, end of year .....	\$ 2,177	\$ 1,897	\$ 720
Supplemental cash flow information:			
Cash paid during the year for income taxes .....	\$ 3,034	\$1,878	\$2,790
Issuance of restricted stock .....	11,507	3,865	3,462
Tax benefit allocated directly to equity .....	440	113	157
Dividends declared and not paid until the subsequent year.....	996	539	460
Assets acquired by recording liabilities.....	-	-	693

See notes to consolidated financial statements.

## WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2006, 2005 and 2004

#### 1. DESCRIPTION OF THE BUSINESS:

Westwood Holdings Group, Inc. (“Westwood”, “we” or “our”) was incorporated under the laws of the State of Delaware on December 12, 2001, as a subsidiary of SWS Group, Inc. (“SWS”). On June 28, 2002, SWS completed the spin-off of Westwood by effecting a dividend distribution of all of the Westwood common stock held by SWS to all of its stockholders on a pro rata basis. Westwood is an independent public company, with SWS having no continuing ownership interest in Westwood. For a more detailed discussion of the spin-off and the various agreements entered into by Westwood and SWS, see the Registration Statement on Form 10 filed by Westwood with the Securities and Exchange Commission on June 6, 2002.

Westwood manages investment assets and provides services for its clients through two subsidiaries, Westwood Management Corp. (“Westwood Management”) and Westwood Trust (“Westwood Trust”). Westwood Management provides investment advisory services to corporate pension funds, public retirement plans, endowments and foundations, mutual funds and also clients of Westwood Trust. Westwood Trust provides to institutions and high net worth individuals trust and custodial services and participation in common trust funds that it sponsors. Revenue is largely dependent on the total value and composition of assets under management. Accordingly, fluctuations in financial markets and in the composition of AUM impact revenue and results of operations.

Westwood Management is a registered investment adviser under the Investment Advisers Act of 1940. Westwood Trust is chartered and regulated by the Texas Department of Banking.

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

##### Basis of Presentation

The accompanying consolidated financial statements are presented using the accrual basis of accounting and include the accounts of Westwood and its wholly-owned subsidiaries, Westwood Management and Westwood Trust. All significant intercompany balances and transactions have been eliminated.

##### Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

##### Revenue Recognition

Investment advisory and trust fees are recognized as services are provided. These fees are determined in accordance with contracts between our subsidiaries and their clients and are generally based on a percentage of assets under management. Most advisory and trust fees are payable in advance or in arrears on a calendar quarterly basis. Advance payments are deferred and recognized over the periods services are performed. Since most of our advance paying clients’ billing periods coincide with the calendar quarter to which payment relates, the revenue related to those clients is fully recognized within the quarter. Consequently, there is not a significant amount of deferred revenue contained in our financial statements. Deferred revenue is shown on the balance sheet under the heading of “Other current liabilities”. Other revenues generally consist of interest and investment income. These revenues are recognized as earned or as the services are performed.

## WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

#### Cash and Cash Equivalents

Cash and cash equivalents consist of short-term, highly liquid investments with maturities of three months or less.

#### Investments

Money market securities are generally classified as available for sale securities and have no significant fluctuating values. All other marketable securities are classified as trading securities. All securities are carried at quoted market value on the accompanying balance sheet. Net unrealized holding gains or losses on investments classified as trading securities are reflected as a component of other revenues. We measure realized gains and losses on investments using the specific identification method.

#### Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation. Depreciation of furniture and equipment is provided over the estimated useful lives of the assets (from 3 to 7 years), and depreciation on leasehold improvements is provided over the lease term, using the straight-line method. We capitalize leasehold improvements, furniture and fixtures, computer hardware and most office equipment purchases. The following table reflects information about our fixed assets as of December 31, 2006 and 2005.

	2006	2005
Leasehold improvements cost.....	\$ 828	\$ 938
Leasehold improvements – accumulated depreciation.....	(127)	(79)
Furniture and fixtures cost.....	696	694
Furniture and fixtures – accumulated depreciation .....	(267)	(170)
Computer hardware and office equipment cost.....	504	445
Computer hardware and office equipment – accumulated depreciation .....	(381)	(274)
Net fixed assets.....	<u>\$1,253</u>	<u>\$1,554</u>

#### Goodwill

During the third quarters of 2006, 2005 and 2004, we completed our annual impairment assessment as required by SFAS 142 "Goodwill and Other Intangible Assets." No impairment losses were required. We perform our annual impairment assessment as of July 1. As of December 31, 2006, Westwood Management and Westwood Trust had net goodwill of \$1,790,000 and \$512,000, respectively.

#### Reclassifications

Reclassifications of prior period amounts have been made to conform to the 2006 presentation. On the balance sheet, reclassification of the prior year current portion of net deferred tax asset was made from non-current "Deferred income taxes" to "Deferred income taxes" in the current assets section.

#### Federal Income Taxes

We file a Federal income tax return as a consolidated group for Westwood and its subsidiaries. Deferred income tax assets and liabilities are determined based on the differences between the financial statement and income tax bases of assets and liabilities as measured at enacted income tax rates. Deferred income tax expense is generally the result of changes in the deferred tax assets and liabilities. Deferred taxes relate primarily to stock-based compensation expense.

## WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

#### Accounting Developments

In June 2006, the Financial Accounting Standards Board (“FASB”) issued Interpretation No. 48 (“FIN 48”), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, “Accounting for Income Taxes”. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. We have evaluated the positions in the tax returns we have filed and the amounts comprising our deferred tax assets and determined that FIN 48 will not have a material impact on our financial statements.

In September 2006, the FASB issued FASB Statement of Financial Accounting Standards No. 157, Fair Value Measurements (“FAS 157”), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles. The provisions of FAS 157 are effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are evaluating the potential impact of the adoption of FAS 157 on our financial statements.

In September 2006, the Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (“SAB 108”). SAB 108 was issued to provide consistency between how registrants quantify financial statement misstatements. SAB 108 established an approach that requires dual quantification of financial statement misstatements based on the effects of the misstatement on the income statement, balance sheet and other disclosures. It is referred to as the “dual” approach as it combines two widely used approaches, which focused on either the income statement or the balance sheet. SAB 108 removes the singular focus on either of those financial statements and the lingering errors that could potentially result. SAB 108 allows registrants to initially apply the dual approach either by (1) retroactively adjusting prior financial statements as if the dual approach had always been used or by (2) recording the cumulative effect of initially applying the dual approach as adjustments to the carrying values of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained earnings. SAB 108 is effective for fiscal years ending after November 15, 2006, and was adopted by us on December 31, 2006. The adoption of SAB 108 had no effect on our financial statements.

#### Stock Based Compensation

We account for stock based compensation in accordance with FASB Statement of Financial Accounting Standards No. 123 Revised (“SFAS No. 123R”). Under SFAS No. 123R, stock based compensation expense reflects the fair value of stock based awards measured at grant date, is recognized over the relevant service period, and is adjusted each period for anticipated forfeitures. We have elected to use the modified prospective transition method as permitted by SFAS No. 123R and therefore have not restated our financial results for prior periods. Under this transition method, we apply the provisions of SFAS No. 123R to new awards and to awards modified, repurchased, or cancelled after January 1, 2006. Additionally, we recognize compensation cost for the portion of awards that were outstanding as of January 1, 2006 for which the requisite service had not been rendered, as the remaining service is rendered. The compensation cost we record for these awards is based on their grant-date fair value as required by SFAS No. 123R. SFAS No. 123R also requires us to report the benefits of tax deductions in excess of recognized compensation expense as a financing cash flow, rather than as an operating cash flow.

We have issued restricted stock and stock options in accordance with its Third Amended and Restated Westwood Holdings Group, Inc. Stock Incentive Plan. We valued stock options issued based upon the Black-Scholes option-pricing model and recognize this value as an expense over the periods in which the options vest. Implementation of the Black-Scholes option-pricing model requires us to make certain assumptions, including expected volatility, risk-free interest rate, expected dividend yield and expected life of the options. We utilized assumptions that we believed to be most appropriate at the time of the valuation. Had we used different assumptions in the pricing model the expense recognized for stock options may have been different than the expense recognized in our financial statements. We must also apply judgment in developing an expectation of awards of restricted stock and



**WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

stock options that may be forfeited. If actual experience differs significantly from these estimates, stock based compensation expense and our results of operations could be materially affected.

**Fair Value of Financial Instruments**

The estimated fair values of our financial instruments have been determined by us using available information. The fair value amounts discussed in Note 4 are not necessarily indicative of either the amounts we would realize upon disposition of these instruments or our intent or ability to dispose of these assets. The estimated fair value of cash and cash equivalents, as well as accounts receivable and payable, approximates their carrying value due to their short-term maturities. The carrying amount of investments designated as “trading” securities, primarily U.S. Government and Government agency obligations as well as mutual fund and common trust fund shares, equals their fair value, which is equal to prices quoted in active markets and, with respect to funds, the net asset value of the shares held as reported by the fund. The carrying amount of investments designated as “available for sale” securities, primarily money market accounts, equals their fair value which is equal to the net asset value of the shares held as reported by the fund. The net asset values of money market holdings generally do not fluctuate.

**3. ACCOUNTS RECEIVABLE:**

Our trade accounts receivable balances do not include any allowance for doubtful accounts nor has any bad debt expense attributable to trade receivables been recorded for the years ended December 31, 2004 through 2005. In 2006, as a result of the termination of our consulting fee arrangement with Gabelli Advisers and the payment of a dividend in its place, we charged \$50,000 of previously accrued consulting revenue to bad debt expense that was in excess of what we received in dividends from Gabelli Advisers. The majority of our accounts receivable balances are advisory and trust fees receivable from customers that we believe and have experienced to be fully collectable.

**4. INVESTMENTS:**

Investment balances are presented in the table below (in thousands). All of these investments are carried at market value. The money market funds are accounted for as available for sale securities. The other investments are accounted for as trading securities.

	<u>Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Market Value</u>
December 31, 2006:				
U.S. Government and Government agency obligations....	\$ 1,757	\$ -	\$ -	\$ 1,757
Funds:				
Money Market .....	12,241	-	-	12,241
Equity .....	3,603	332	-	3,935
Marketable securities .....	<u>\$17,601</u>	<u>\$332</u>	<u>\$ -</u>	<u>\$17,933</u>
December 31, 2005:				
U.S. Government and Government agency obligations....	\$ 1,686	\$ -	\$ -	\$ 1,686
Funds:				
Money Market .....	13,206	-	-	13,206
Equity .....	2,797	189	-	2,986
Marketable securities .....	<u>\$17,689</u>	<u>\$189</u>	<u>\$ -</u>	<u>\$17,878</u>

**WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

The following amounts are included in our income statement under the heading “Other revenues” for the years indicated:

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Realized gains.....	\$329,000	\$170,000	\$440,000
Realized losses .....	(9,000)	-	(3,000)
Net realized gains .....	320,000	170,000	437,000
Interest income .....	752,000	498,000	195,000
Dividend income .....	329,000	29,000	77,000
Unrealized gains .....	143,000	64,000	56,000
Consulting income .....	48,000	280,000	328,000

**5. INCOME TAXES:**

Income tax expense for the years ended December 31, 2006, 2005 and 2004 (effective rates of 38.4%, 39.8% and 38.4%, respectively) differs from the amount that would otherwise have been calculated by applying the Federal corporate tax rate (34%) to income before income taxes. The difference between the Federal corporate tax rate of 34% and the effective tax rate is comprised of the following (in thousands):

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Income tax expense at the statutory rate.....	\$2,466	\$2,055	\$2,035
State franchise and income taxes.....	412	296	272
Other, net.....	(93)	56	(8)
Total income tax expense .....	\$2,785	\$2,407	\$2,299

Income taxes as set forth in the consolidated statements of income consisted of the following components (in thousands):

	<b>2006</b>	<b>2005</b>	<b>2004</b>
State – current.....	\$ 638	\$ 454	\$ 369
State – deferred.....	(5)	(4)	22
Federal – current.....	2,811	2,253	2,083
Federal – deferred.....	(659)	(296)	(175)
Total income tax expense .....	\$2,785	\$2,407	\$2,299

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities as of December 31, 2006 and 2005 are presented below (in thousands):

	<b>2006</b>	<b>2005</b>
Depreciation at rates different for tax than for financial reporting.....	\$ (154)	\$(197)
Restricted stock amortization .....	1,427	741
Stock option expense.....	239	254
Other.....	(31)	19
Total deferred tax assets.....	\$1,481	\$ 817

**WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Net deferred tax assets and liabilities are reflected on our balance sheet as of December 31, 2006 and 2005 as follows:

	<b>2006</b>	<b>2005</b>
Net current deferred tax asset, included in other current assets .....	\$1,267	\$ 573
Non-current deferred tax asset .....	490	513
Non-current deferred tax liabilities .....	(276)	(269)
Total net deferred tax assets .....	\$1,481	\$ 817

As a result of our history of taxable income and the nature of the items from which deferred tax assets are derived, management believes that it is more likely than not that we will realize the benefit of the deferred tax assets. We include penalties and interest on income based taxes in the “Provision for income taxes” line on our income statement. We recorded \$77 of penalties and interest in 2006. There were no penalties or interest recorded in 2004 and 2005. For federal income taxes, 2003, 2004 and 2005 are open tax years. For Texas franchise taxes, 2004, 2005 and 2006 are open tax years.

**6. REGULATORY CAPITAL REQUIREMENTS:**

Westwood Trust is subject to the capital requirements of the Texas Department of Banking, and has a minimum capital requirement of \$1.0 million. At December 31, 2006, Westwood Trust had total stockholders’ equity of approximately \$3.7 million, which is \$2.7 million in excess of its minimum capital requirement.

Westwood Trust is limited under applicable Texas law in the payment of dividends to undivided profits: that part of equity capital equal to the balance of net profits, income, gains and losses since its formation date minus subsequent distributions to stockholders and transfers to surplus or capital under share dividends or appropriate Board resolutions. At the discretion of its board of directors, Westwood Trust has made quarterly and special dividend payments to us out of its undivided profits.

**7. EMPLOYEE BENEFITS:**

We have issued stock options and restricted shares to our employees and non-employee directors and offer 401(k) matching and profit sharing contributions to our employees. The Third Amended and Restated Westwood Holdings Group, Inc. Stock Incentive Plan (the “Plan”) reserves shares of Westwood common stock for issuance to eligible employees and directors of Westwood or its subsidiaries in the form of restricted stock and stock options. The total number of shares that may be issued under the Plan (including the predecessor plans to the Plan) may not exceed 1,948,100 shares. In the event of a change in control of Westwood, the Plan contains provisions providing for the acceleration of the vesting of restricted stock and stock options. At December 31, 2006, approximately 580,000 shares remain available for issuance under the Plan.

The following table presents the total stock-based compensation expense we recorded and the total income tax benefit recognized for stock-based compensation arrangements for the years indicated:

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Total stock based compensation expense .....	\$4,626,000	\$2,364,000	\$1,499,000
Total income tax benefit recognized related to stock-based compensation.....	930,000	515,000	194,000

We recorded certain adjustments to comply with SFAS No. 123R. Since we accounted for forfeitures of equity based awards as they occurred instead of estimating the effect of forfeitures when applying the original Statement of Financial Accounting Standards No. 123, on January 1, 2006 we recorded a cumulative effect of a change in accounting principle totaling \$39,000, net of tax, in order to reverse compensation expense recorded for unvested securities as of December 31, 2005 that was in excess of what we estimate will vest. The amount of stock based compensation expense

**WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

recorded in continuing operations in 2006 using estimated forfeitures was approximately \$27,000 more than it would have been had we not estimated forfeitures and continued to account for forfeitures as they occurred.

**Restricted Stock**

We have granted restricted stock to employees and non-employee directors, which are subject to a service condition, and to the Chief Executive Officer and Chief Investment Officer, which are subject to a service condition and performance goals. Until the shares vest, they are restricted from sale, transfer or assignment in accordance with the terms of the agreements under which they were issued. We calculate compensation cost for restricted stock grants by using the fair market value of our common stock at the date of grant, the number of shares issued and an estimate of shares that will not vest due to forfeitures. This compensation cost is amortized on a straight-line basis over the applicable vesting period. In order to satisfy tax liabilities that employees will owe on their shares that vest, we may withhold a sufficient number of vested shares from employees on or about the date vesting occurs. For 2007, we estimate that the number of shares that could potentially be withheld for this purpose could total approximately 57,000 shares. Our two types of restricted stock grants are discussed below.

*Employee and non-employee director restricted share grants*

For the years ended December 31, 2006, 2005 and 2004, we granted restricted stock to employees and non-employee directors. The employees' shares vest over four years and the directors' shares vest over one year. The following table details the status and changes in our restricted stock grants that are subject only to a service condition for the year ended December 31, 2006:

<b>Restricted shares subject only to a service condition:</b>	<u>Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Non-vested , January 1, 2006 .....	472,000	\$18.41
Granted.....	228,600	18.05
Vested.....	(133,996)	18.50
Forfeited .....	<u>(7,816)</u>	18.37
Non-vested , December 31, 2006 .....	<u>558,788</u>	18.24

The following table shows the weighted-average grant date fair value for shares granted and the total fair value of shares vested during the years indicated:

<b>Restricted shares subject only to a service condition:</b>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Weighted-average grant date fair value.....	\$18.05	\$18.29	\$18.00
Fair value of shares vested .....	\$2,523,000	\$1,415,000	\$81,000

*CEO and CIO performance-based restricted share grants*

We granted shares to the Chief Executive Officer and the Chief Investment Officer that vest over four years and six years, respectively, provided annual performance goals established by the compensation committee are met. For the first vesting year, 2006, the officers became vested in the applicable percentage of their restricted shares since Westwood's adjusted pre-tax income for 2006 was at least 10% greater than Westwood's adjusted pre-tax income for the year 2005. In each subsequent year during the applicable vesting period, the compensation committee will establish a specific goal for that year's vesting of the restricted shares, which will be based in all cases upon Westwood's adjusted pre-tax income, as defined. If in any year during the vesting period the performance goal is not met, the compensation committee may establish a goal for a subsequent vesting period, which if achieved or exceeded may result in full or partial vesting of the shares that did not otherwise become vested in a prior year. However, in no event will the maximum number of shares, which may become vested over the vesting period, exceed 100,000 shares

**WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

in the case of our Chief Executive Officer and 300,000 shares in the case of our Chief Investment Officer. If a portion of the performance-based restricted shares do not vest, no compensation expense is recognized for that portion and any previously recognized compensation expense related to the shares that do not vest would be reversed.

<b>Restricted shares subject to service and performance conditions:</b>	<b>Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
	<u>Shares</u>	<u>Value</u>
Non-vested, January 1, 2006 .....	-	-
Granted.....	400,000	\$18.81
Vested.....	(75,000)	18.81
Forfeited .....	-	-
Non-vested, December 31, 2006 .....	<u>325,000</u>	18.81

Because the performance goal was met in 2006, the shares are vested in substance, but require certification by the compensation committee of Westwood, at which time a share price will be determined for tax purposes. As a result, we estimate that the total fair value of the shares that vested in 2006 was \$1,727,000, which uses a share price of \$23.03, the closing price of our stock as of the last business day of 2006. The weighted-average grant date fair value of these vested shares was \$18.81. There were no performance-based restricted shares issued before 2006.

**Stock Options**

Options granted under the Stock Incentive Plan have a maximum ten-year term and vest over a period of four years. Options exercised represent newly issued shares. Westwood's outstanding stock options, which were all exercisable as of December 31, 2006, have exercise prices ranging from \$12.90 to \$14.80 and a weighted-average remaining contractual life of 5.5 years. A summary of the status of Westwood's outstanding stock options as of December 31, 2006, 2005 and 2004 is presented below.

	<u>December 31, 2006</u>		<u>December 31, 2005</u>		<u>December 31, 2004</u>	
	<u>Underlying Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Underlying Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Underlying Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding, beginning of period.....	155,625	\$12.93	176,625	\$12.92	189,175	\$12.92
Granted .....	-	-	-	-	-	-
Exercised.....	(31,094)	12.95	(21,000)	12.90	(11,175)	12.90
Forfeited.....	-	-	-	-	(1,375)	12.90
Outstanding, end of period.....	<u>124,531</u>	12.92	<u>155,625</u>	12.93	<u>176,625</u>	12.92
Exercisable, end of period.....	124,531	12.92	110,000	12.93	85,250	12.92
Intrinsic value – outstanding.....	\$1,259,000		\$824,000		\$1,197,000	
Intrinsic value – exercisable.....	1,259,000		582,000		578,000	

The following table displays information for Westwood stock options exercised for the periods presented:

	<u>For the years ended</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Total intrinsic value of options exercised.....	\$213,000	\$ 94,000	\$ 63,000
Cash received from the exercise of stock options.....	402,000	271,000	144,000

**WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

**Westwood Holdings Group, Inc. Savings Plan**

Westwood has a defined contribution 401(k) and profit sharing plan that was adopted in July 2002 and covers all of our employees. Discretionary employer profit sharing contributions become fully vested after six years of service by the participant. Profit sharing expense related to our employees for 2006, 2005 and 2004 was approximately \$308,000, \$282,000 and \$242,000, respectively. For the 401(k) portion of the plan, Westwood provided a match in 2006 and 2005 of up to 6% of eligible compensation, an increase from the 4% match provided in 2004. Westwood's matching contributions vest immediately and the expense totaled approximately \$308,000, \$280,000 and \$200,000 in 2006, 2005 and 2004, respectively.

**8. EARNINGS PER SHARE:**

Basic earnings per common share is computed by dividing net income available to common stockholders by the weighted average number of shares outstanding for the periods ended December 31, 2006, 2005 and 2004, respectively. Diluted earnings per share for these periods is computed based on the weighted average number of shares outstanding plus the effect of the dilutive impact of stock options, restricted stock and shares held in the Westwood Holdings Group, Inc. Deferred Compensation Plan, which was terminated in 2004. Diluted earnings per common share is computed using the treasury stock method.

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share and share amounts):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Net income .....	\$4,508	\$3,636	\$3,686
Weighted average shares outstanding – basic .....	5,594,139	5,464,033	5,405,133
Dilutive potential shares from stock options .....	45,766	43,125	33,087
Dilutive potential shares from restricted shares.....	50,550	33,184	-
Dilutive potential shares from deferred compensation plan .....	-	-	271
Weighted average shares outstanding – diluted.....	<u>5,690,455</u>	<u>5,540,342</u>	<u>5,438,491</u>
Earnings per share – basic .....	\$0.81	\$0.67	\$0.68
Earnings per share – diluted .....	\$0.79	\$0.66	\$0.68

**9. COMMITMENTS AND CONTINGENCIES:**

We lease our offices under a non-cancelable operating lease agreement. Rental expense for facilities and equipment leases for fiscal years 2006, 2005 and 2004 aggregated approximately \$684,000, \$664,000 and \$629,000, respectively, and is included in general and administrative and information technology expenses in the accompanying consolidated statements of income.

At December 31, 2006, the future contractual rental payments for non-cancelable operating leases for each of the following five years and thereafter follow (in thousands):

Year ending:	
2007 .....	\$ 626
2008 .....	639
2009 .....	653
2010 .....	672
2011 .....	<u>279</u>
Total payments due .....	<u>\$2,869</u>

**WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

**10. SEGMENT REPORTING:**

We operate two segments: the Westwood Management segment and the Westwood Trust segment. Such segments are managed separately based on types of products and services offered and their related client bases. We evaluate the performance of our segments based primarily on income before income taxes. All segment accounting policies are the same as those described in the summary of significant accounting policies. Intersegment balances that eliminate in consolidation have been applied to the appropriate segment.

**Westwood Management**

The Westwood Management segment provides investment advisory services to corporate pension funds, public retirement plans, endowments and foundations and the WHG Funds, and investment subadvisory services to mutual funds and clients of Westwood Trust.

**Westwood Trust**

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

	<b>Westwood Management</b>	<b>Westwood Trust</b>	<b>Other</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>2006</b>					
Net revenues from external sources .....	\$18,970	\$8,394	\$ -	\$ -	\$27,364
Net intersegment revenues .....	3,050	5	-	(3,055)	-
Net interest and dividend revenue .....	927	154	-	-	1,081
Depreciation and amortization .....	202	64	-	-	266
Income tax expense (benefit) .....	3,647	731	(1,593)	-	2,785
Income (loss) before income taxes .....	9,955	1,925	(4,626)	-	7,254
Segment assets.....	22,190	4,512	2,020	-	28,722
Expenditures for long-lived assets.....	54	16	-	-	70
<b>2005</b>					
Net revenues from external sources .....	\$14,821	\$7,119	\$ -	\$ -	\$21,940
Net intersegment revenues .....	2,808	6	-	(2,814)	-
Net interest and dividend revenue .....	439	48	-	-	487
Depreciation and amortization .....	208	64	-	-	272
Income tax expense (benefit) .....	2,609	536	(738)	-	2,407
Income (loss) before income taxes .....	6,994	1,413	(2,364)	-	6,043
Segment assets.....	21,274	4,495	1,541	-	27,310
Expenditures for long-lived assets.....	53	22	-	-	75
<b>2004</b>					
Net revenues from external sources .....	\$14,055	\$5,887	\$ 38	\$ -	\$19,980
Net intersegment revenues .....	2,344	8	-	(2,352)	-
Net interest and dividend revenue .....	231	19	8	-	258
Depreciation and amortization .....	149	42	-	-	191
Income tax expense (benefit) .....	2,541	333	(575)	-	2,299
Income (loss) before income taxes .....	6,706	857	(1,578)	-	5,985
Segment assets.....	20,756	3,844	1,677	-	26,277
Expenditures for long-lived assets.....	894	295	-	-	1,189

**11. CONCENTRATION:**

During the years ended December 31, 2006, 2005 and 2004, no customer accounted for 10% or more of our revenues. For the year ended December 31, 2006, our largest four clients accounted for 25.6% of total revenues.

**WESTWOOD HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

**12. SUBSEQUENT EVENT:**

On February 7, 2007, we declared a quarterly cash dividend of \$0.20 per share on common stock payable on April 2, 2007 for stockholders of record on March 15, 2007.

**13. QUARTERLY FINANCIAL DATA (Unaudited):**

The following is a summary of unaudited quarterly results of operations for the years ended December 31, 2006 and 2005 (in thousands, except per share amounts):

	<b>Quarter</b>			
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>
<b>2006</b>				
Revenues .....	\$6,511	\$6,639	\$6,895	\$7,319
Income before income taxes.....	2,043	1,617	1,564	2,030
Income before cumulative effect of accounting change.....	1,257	986	921	1,305
Net income .....	1,296	986	921	1,305
Basic income before cumulative effect of accounting change per common share.....	0.23	0.18	0.16	0.23
Diluted income before cumulative effect of accounting change per common share.....	0.22	0.18	0.16	0.22
Basic earnings per common share .....	0.23	0.18	0.16	0.23
Diluted earnings per common share .....	0.23	0.18	0.16	0.22
<b>2005</b>				
Revenues .....	\$5,082	\$5,253	\$5,554	\$6,051
Income before income taxes.....	1,421	1,526	1,433	1,663
Net income .....	875	937	814	1,010
Basic earnings per common share .....	0.16	0.17	0.15	0.18
Diluted earnings per common share .....	0.16	0.17	0.15	0.18



# Corporate Information

## Board of Directors

### Susan M. Byrne

Chairman & Chief Investment Officer,  
Westwood Holdings Group, Inc.

### Brian O. Casey

President & Chief Executive Officer,  
Westwood Holdings Group, Inc.

### Tom C. Davis <sup>(1)(2)</sup>

Chief Executive Officer,  
The Concorde Group

### Richard M. Frank <sup>(1)(3)</sup>

Chief Executive Officer,  
CEC Entertainment, Inc.

### Frederick R. Meyer <sup>(1)(2)(3)</sup>

Private Investor

### Jon L. Mosle, Jr. <sup>(1)(2)(3)</sup>

Retired Vice Chairman,  
Rotan Mosle, Inc.

### Raymond E. Wooldridge <sup>(1)(2)(3)</sup>

Private Investor

(1) Audit Committee Member

(2) Compensation Committee Member

(3) Governance/Nominating Committee Member

## Senior Management

### Susan M. Byrne

Chairman & Chief Investment Officer

### Brian O. Casey

President & Chief Executive Officer

### William R. Hardcastle, Jr., CFA

Vice President &  
Chief Financial Officer

### Joyce A. Schaer

Senior Vice President &  
Director of Marketing

## Stockholder Information

### Corporate Offices

Westwood Holdings Group, Inc.  
200 Crescent Court, Suite 1200  
Dallas, Texas 75201  
(214) 756-6900

### Stock Exchange Listing

New York Stock Exchange  
Common Stock  
Ticker Symbol: WHG

### Transfer Agent & Registrar

Computershare Trust Company, Inc.  
350 Indiana Street, Suite 800  
Golden, Colorado 80401  
(800) 962-4284

### Independent Auditors

Grant Thornton LLP  
Dallas, Texas

### Corporate Counsel

Fulbright & Jaworski LLP  
Dallas, Texas

### Annual Meeting of Stockholders

Thursday, April 26, 2007, 10:00 am  
The Crescent Club  
200 Crescent Court, 17th Floor  
Dallas, Texas 75201

For more information about Westwood Holdings Group, Inc., visit our website at [www.westwoodgroup.com](http://www.westwoodgroup.com) or e-mail [info@westwoodgroup.com](mailto:info@westwoodgroup.com). You may obtain information about the WHG Funds by visiting [www.whgfunds.com](http://www.whgfunds.com) or by calling (877) FUND-WHG.

## Certifications Regarding Public Disclosures & Listings Standards

Westwood Holdings Group, Inc. has filed with the Securities and Exchange Commission as exhibits 31.1 and 31.2 to its Form 10-K for the year ended December 31, 2006, the certifications required by Section 302 of the Sarbanes-Oxley Act regarding the quality of the company's public disclosure. In addition, the annual certification of the Chief Executive Officer regarding compliance by Westwood Holdings Group, Inc. with the corporate governance listing standards of the New York Stock Exchange was submitted without qualification to the New York Stock Exchange following the April 2006 annual stockholder meeting.



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HOLDINGS GROUP, INC.®