

WADDELL & REED FINANCIAL INC

Form 10-Q

November 01, 2013

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2013**

**OR**

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

**For the transition period from** \_\_\_\_\_ **to** \_\_\_\_\_

**Commission file number 001-13913**

# WADDELL & REED FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction  
of incorporation or organization)

**51-0261715**

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

**6300 Lamar Avenue**

**Overland Park, Kansas 66202**

(Address, including zip code, of Registrant's principal executive offices)

**(913) 236-2000**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

Shares outstanding of each of the registrant's classes of common stock as of the latest practicable date:

**Class**

**Outstanding as of October 24, 2013**

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Class A common stock, \$.01 par value

85,416,415

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**WADDELL & REED FINANCIAL, INC.**

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****WADDELL & REED FINANCIAL, INC. AND SUBSIDIARIES**

## Consolidated Balance Sheets

(in thousands)

|  | September 30,<br>2013<br>(unaudited) | December 31,<br>2012 |
|--|--------------------------------------|----------------------|
| Assets:  |                                      |                      |
| Cash and cash equivalents                            | \$ 426,643                           | 328,027              |
| Cash and cash equivalents - restricted               | 101,919                              | 92,980               |
| Investment securities                                | 196,100                              | 176,142              |
| Receivables:   |                                      |                      |
| Funds and separate accounts                          | 33,833                               | 33,886               |
| Customers and other                                  | 110,572                              | 136,073              |
| Deferred income taxes                                | 5,599                                | 7,978                |
| Income taxes receivable                              |                                      | 5,577                |
| Prepaid expenses and other current assets            | 9,819                                | 9,080                |
| Assets of discontinued operations held for sale      |                                      | 15,150               |
| Total current assets                                 | 884,485                              | 804,893              |
| Property and equipment, net                          | 70,349                               | 69,328               |
| Deferred sales commissions, net                      | 76,250                               | 69,355               |
| Goodwill and identifiable intangible assets          | 161,969                              | 161,969              |
| Deferred income taxes                                | 25,876                               | 17,797               |
| Other non-current assets                             | 13,181                               | 11,491               |
| Assets of discontinued operations held for sale      |                                      | 18,010               |
| Total assets   | \$ 1,232,110                         | 1,152,843            |
| Liabilities:   |                                      |                      |
| Accounts payable                                     | \$ 16,345                            | 23,795               |
| Payable to investment companies for securities       | 142,361                              | 152,749              |
| Payable to third party brokers                       | 57,353                               | 46,169               |
| Payable to customers                                 | 27,474                               | 45,182               |
| Accrued compensation                                 | 64,211                               | 46,347               |
| Other current liabilities                            | 41,802                               | 43,504               |
| Income taxes payable                                 | 2,077                                |                      |
| Liabilities of discontinued operations held for sale |                                      | 7,587                |
| Total current liabilities                            | 351,623                              | 365,333              |
| Long-term debt                                       | 190,000                              | 190,000              |
| Accrued pension and postretirement costs             | 51,992                               | 62,458               |
| Other non-current liabilities                        | 26,141                               | 24,531               |
| Liabilities of discontinued operations held for sale |                                      | 281                  |
| Total liabilities                                    | 619,756                              | 642,603              |

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## Commitments and contingencies

### Stockholders' equity:

Preferred stock-\$1.00 par value: 5,000 shares authorized; none issued

Class A Common stock-\$0.01 par value: 250,000 shares authorized; 99,701 shares issued; 85,417 shares outstanding (85,679 at December 31, 2012)

|  |              |           |
|--|--------------|-----------|
|  | 997          | 997       |
| Additional paid-in capital   | 251,284      | 230,021   |
| Retained earnings  | 800,634      | 698,423   |
| Cost of 14,284 common shares in treasury (14,022 at December 31, 2012) | (400,026)    | (372,404) |
| Accumulated other comprehensive loss                                   | (40,535)     | (46,797)  |
| Total stockholders' equity   | 612,354      | 510,240   |
| Total liabilities and stockholders' equity                             | \$ 1,232,110 | 1,152,843 |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents**WADDELL & REED FINANCIAL, INC. AND SUBSIDIARIES**

## Consolidated Statements of Income

(Unaudited, in thousands, except for per share data)

|  | For the three months<br>ended September 30, |          | For the nine months<br>ended September 30, |          |
|--|---|----------|--|----------|
|  | 2013  | 2012     | 2013                                       | 2012     |
| <b>Revenues:</b>   |   |          |  |          |
| Investment management fees   | \$ 165,559                                  | 138,364  | 470,223                                    | 407,477  |
| Underwriting and distribution fees   | 146,863                                     | 122,819  | 423,879                                    | 367,659  |
| Shareholder service fees   | 34,667                                      | 32,182   | 101,248                                    | 95,786   |
| Total  | 347,089                                     | 293,365  | 995,350                                    | 870,922  |
| <b>Operating expenses:</b>   |   |          |  |          |
| Underwriting and distribution  | 169,046                                     | 147,408  | 495,461                                    | 439,961  |
| Compensation and related costs (including<br>share-based compensation of \$14,186, \$12,299,<br>\$39,192 and \$36,217, respectively) | 49,472                                      | 42,343   | 145,003                                    | 128,432  |
| General and administrative   | 20,462                                      | 15,774   | 63,608                                     | 57,172   |
| Subadvisory fees   | 1,667                                       | 4,921    | 10,442                                     | 16,400   |
| Depreciation   | 3,172                                       | 3,188    | 9,621                                      | 9,876    |
| Total  | 243,819                                     | 213,634  | 724,135                                    | 651,841  |
| Operating income   | 103,270                                     | 79,731   | 271,215                                    | 219,081  |
| Investment and other income  | 5,212                                       | 2,632    | 10,591                                     | 7,906    |
| Interest expense   | (2,832)                                     | (2,826)  | (8,544)                                    | (8,477)  |
| Income from continuing operations before<br>provision for income taxes   | 105,650                                     | 79,537   | 273,262                                    | 218,510  |
| Provision for income taxes   | 37,231                                      | 27,421   | 99,023                                     | 78,332   |
| Income from continuing operations  | 68,419                                      | 52,116   | 174,239                                    | 140,178  |
| Loss from discontinued operations net of tax<br>expense of \$0, \$473, \$0 and \$1,278, respectively                                 |   | (43,590) |  | (42,547) |
| Net income   | \$ 68,419                                   | 8,526    | 174,239                                    | 97,631   |
| <b>Net income (loss) per share, basic and diluted:</b>   |   |          |  |          |
| Income from continuing operations  | \$ 0.80                                     | 0.61     | 2.03                                       | 1.63     |
| Loss from discontinued operations  |   | (0.51)   |  | (0.49)   |
| Net income   | \$ 0.80                                     | 0.10     | 2.03                                       | 1.14     |
| <b>Weighted average shares outstanding:</b>  |   |          |  |          |
| Basic  | 85,603                                      | 85,753   | 85,688                                     | 85,817   |
| Diluted  | 85,603                                      | 85,755   | 85,689                                     | 85,819   |

See accompanying notes to the unaudited consolidated financial statements.





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**WADDELL & REED FINANCIAL, INC. AND SUBSIDIARIES**

Consolidated Statements of Comprehensive Income

(Unaudited, in thousands)

|  |    | For the three months<br>ended September 30, |        | For the nine months<br>ended September 30, |         |
|--|----|---|--------|--|---------|
|  |    | 2013  | 2012   | 2013                                       | 2012    |
| Net income   | \$ | 68,419                                      | 8,526  | 174,239                                    | 97,631  |
| Other comprehensive income:  |    |   |        |  |         |
| Unrealized appreciation of available for sale investment securities during the period, net of income tax expense of \$12, \$2, \$3 and \$1, respectively |    | 4,633                                       | 2,399  | 4,008                                      | 4,741   |
| Pension and postretirement benefits, net of income tax expense of \$480, \$481, \$1,633 and \$1,528, respectively  |    | 816   | 816    | 2,254                                      | 2,364   |
| Comprehensive income   | \$ | 73,868                                      | 11,741 | 180,501                                    | 104,736 |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents**WADDELL & REED FINANCIAL, INC. AND SUBSIDIARIES**

## Consolidated Statement of Stockholders' Equity

For the Nine Months Ended September 30, 2013

(Unaudited, in thousands)

|  | Shares | Common Stock<br>Amount | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total<br>Stockholders<br>Equity |
|--|--------|------------------------|----------------------------------|----------------------|-------------------|--|---------------------------------|
| Balance at December 31, 2012   | 99,701 | \$ 997                 | 230,021                          | 698,423              | (372,404)         | (46,797)   | 510,240                         |
| Net income   |        |                        |                                  | 174,239              |                   |  | 174,239                         |
| Recognition of equity compensation                                     |        |                        | 39,192                           |                      |                   |  | 39,192                          |
| Net issuance/forfeiture of nonvested shares                            |        |                        | (24,754)                         |                      | 24,754            |  |                                 |
| Dividends accrued, \$0.84 per share                                    |        |                        |                                  | (72,028)             |                   |  | (72,028)                        |
| Exercise of stock options  |        |                        | (35)                             |                      | 170               |  | 135                             |
| Excess tax benefits from share-based<br>payment arrangements           |        |                        | 6,860                            |                      |                   |  | 6,860                           |
| Repurchase of common stock   |        |                        |                                  |                      | (52,546)          |  | (52,546)                        |
| Unrealized appreciation on available for<br>sale investment securities |        |                        |                                  |                      |                   | 4,008  | 4,008                           |
| Pension and postretirement benefits                                    |        |                        |                                  |                      |                   | 2,254  | 2,254                           |
| Balance at September 30, 2013  | 99,701 | \$ 997                 | 251,284                          | 800,634              | (400,026)         | (40,535)   | 612,354                         |

See accompanying notes to the unaudited consolidated financial statements.

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## Consolidated Statements of Cash Flows

(Unaudited, in thousands)

|   | <b>For the nine months<br/>ended September 30,</b> |             |
|---|--|-------------|
|   | <b>2013</b>  | <b>2012</b> |
| Cash flows from operating activities:   |  |             |
| Net income  | \$ 174,239   | 97,631      |
| Adjustments to reconcile net income to net cash provided by operating activities:   |  |             |
| Write-down of impaired assets   |  | 42,373      |
| Depreciation and amortization   | 10,351   | 11,369      |
| Amortization of deferred sales commissions  | 41,569   | 40,142      |
| Share-based compensation  | 39,192   | 37,146      |
| Excess tax benefits from share-based payment arrangements                           | (6,860)  | (3,298)     |
| Gain on sale of available for sale investment securities                            | (7,887)  | (3,163)     |
| Net purchases and sales or maturities of trading securities                         | (27,394)   | (37,806)    |
| Loss (gain) on trading securities   | (2,862)  | 330         |
| Loss on sale and retirement of property and equipment                               | 302  | 5,205       |
| Capital gains and dividends reinvested  | (50)   |             |
| Deferred income taxes   | (7,335)  | (7,243)     |
| Changes in assets and liabilities:  |  |             |
| Cash and cash equivalents - restricted  | (8,939)  | (32,662)    |
| Other receivables   | 25,501   | (44,204)    |
| Payable to investment companies for securities and payable to customers             | (28,096)   | 66,254      |
| Receivables from funds and separate accounts  | 53   | (7,975)     |
| Other assets  | (2,429)  | 1,550       |
| Deferred sales commissions  | (48,464)   | (41,494)    |
| Accounts payable and payable to third party brokers                                 | 3,734  | 6,415       |
| Other liabilities   | 26,769   | 19,817      |
| Net cash provided by operating activities   | \$ 181,394   | 150,387     |
| Cash flows from investing activities:   |  |             |
| Purchases of available for sale investment securities                               | (137,828)  | (41,676)    |
| Proceeds from sales and maturities of available for sale investment securities      | 159,343  | 48,431      |
| Additions to property and equipment   | (10,944)   | (11,233)    |
| Disposition of companies  | 22,000   |             |
| Net cash provided by (used in) investing activities                                 | \$ 32,571  | (4,478)     |
| Cash flows from financing activities:   |  |             |
| Dividends paid  | (72,101)   | (64,455)    |
| Repurchase of common stock  | (52,546)   | (36,004)    |
| Exercise of stock options   | 135  |             |
| Excess tax benefits from share-based payment arrangements                           | 6,860  | 3,298       |
| Net cash used in financing activities   | \$ (117,652)                                       | (97,161)    |
| Net increase in cash and cash equivalents   | 96,313   | 48,748      |
| Cash and cash equivalents at beginning of period, including discontinued operations | 330,330  | 327,083     |
| Cash and cash equivalents at end of period  | 426,643  | 375,831     |
| Less cash and cash equivalents of discontinued operations at end of period          |  | 2,754       |

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|   |    |         |         |
|---|----|---------|---------|
| Cash and cash equivalents of continuing operations at end of period | \$ | 426,643 | 373,077 |
|---|----|---------|---------|

See accompanying notes to the unaudited consolidated financial statements.

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**WADDELL & REED FINANCIAL, INC.**

**NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Description of Business and Significant Accounting Policies**

*Waddell & Reed Financial, Inc. and Subsidiaries*

Waddell & Reed Financial, Inc. and subsidiaries (hereinafter referred to as the Company, we, our and us) derive revenues from investment management, investment product underwriting and distribution, and shareholder services administration provided to the Waddell & Reed Advisors Group of Mutual Funds (the Advisors Funds), Ivy Funds (the Ivy Funds), Ivy Funds Variable Insurance Portfolios (the Ivy Funds VIP) and InvestEd Portfolios (InvestEd) (collectively, the Advisors Funds, Ivy Funds, Ivy Funds VIP and InvestEd are referred to as the Funds), and institutional and separately managed accounts. The Funds and the institutional and separately managed accounts operate under various rules and regulations set forth by the United States Securities and Exchange Commission (the SEC). Services to the Funds are provided under investment management agreements, underwriting agreements and shareholder servicing and accounting service agreements that set forth the fees to be charged for these services. The majority of these agreements are subject to annual review and approval by each Fund's board of trustees. Our revenues are largely dependent on the total value and composition of assets under management. Accordingly, fluctuations in financial markets and composition of assets under management can significantly impact revenues and results of operations.

*Basis of Presentation*

We have prepared the accompanying unaudited consolidated financial statements included herein pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations, although we believe that the disclosures are adequate to enable a reasonable understanding of the information presented. The information in this Quarterly Report on Form 10-Q should be read in conjunction with Part I, Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations and our audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2012 (the 2012 Form 10-K). Certain amounts in the prior years' financial statements have been reclassified for consistent presentation.

The accompanying unaudited consolidated financial statements are prepared consistently with the accounting policies described in Note 2 to the consolidated financial statements included in our 2012 Form 10-K, which include the following: use of estimates, cash and cash equivalents, disclosures about fair value of financial instruments, investment securities and investments in affiliated mutual funds, property and equipment, software developed for internal use, goodwill and identifiable intangible assets, deferred sales commissions, revenue recognition, advertising and promotion, share-based compensation and accounting for income taxes.

Effective January 1, 2013, the Company adopted an amended accounting standard to improve the reporting of reclassifications out of accumulated other comprehensive income. The guidance requires an entity to present separately, for each component of comprehensive income, the current period reclassifications out of accumulated other comprehensive income by the respective line items of net income affected by the reclassification. The adoption was effective prospectively and did not have any effect on the Company's results of operations, financial position

or liquidity.

In our opinion, the accompanying unaudited consolidated financial statements reflect all adjustments (consisting of only a normal and recurring nature) necessary to present fairly our financial position at September 30, 2013, the results of operations for the three and nine months ended September 30, 2013 and 2012, and cash flows for the nine months ended September 30, 2013 and 2012 in conformity with accounting principles generally accepted in the United States.

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During the third quarter of 2012, the Company committed to a plan to sell its Legend group of subsidiaries ( Legend ) and on October 29, 2012, the Company signed a definitive agreement to execute the transaction. The sale closed effective January 1, 2013. The operational results of Legend have been reclassified as discontinued operations in our unaudited consolidated financial statements for the three and nine months ended September 30, 2012 and as of December 31, 2012. Unless otherwise stated, footnote references refer to continuing operations.

**2. Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand and short-term investments. We consider all highly liquid investments with maturities upon acquisition of 90 days or less to be cash equivalents. Cash and cash equivalents restricted represents cash held for the benefit of customers segregated in compliance with federal and other regulations.

**3. Accounting Pronouncements Not Yet Adopted**

In July 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-06, Other Topics (Topic 720): Fees Paid to the Federal Government by Health Insurers ( ASU 2011-06 ). This ASU was issued to address questions about how health insurers should recognize and classify in their income statements fees mandated by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act (collectively, the Acts ). The Acts impose an annual fee on health insurers for each calendar year beginning on or after January 1, 2014. A health insurer's portion of the annual fee is payable no later than September 30 of the applicable calendar year and is not tax deductible. The ASU specifies that the liability for the fee should be estimated and recorded in full once the entity provides qualifying health insurance in the applicable calendar year in which the fee is payable. A corresponding deferred cost is amortized to expense using a straight-line method of allocation unless another method better allocates the fee over the calendar year in which it is payable. ASU 2011-06 is effective for calendar years beginning after December 31, 2013. The Company believes that the adoption of ASU 2011-06 in 2014 will result in an immaterial impact to its consolidated financial statements.

In July 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ( ASU 2013-11 ). Under this standard, an unrecognized tax benefit should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward, rather than as a liability, when the uncertain tax position would reduce the net operating loss or other carryforward under the tax law. ASU 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The Company believes that adoption of ASU 2013-11 in 2014 will result in an immaterial impact to its consolidated financial statements.

Table of Contents**4. Investment Securities**

Investment securities at September 30, 2013 and December 31, 2012 are as follows:

| September 30, 2013                    | Amortized<br>cost | Unrealized<br>gains | Unrealized<br>losses | Fair value |
|---------------------------------------|-------------------|---------------------|----------------------|------------|
| (in thousands)                        |                   |                     |                      |            |
| <b>Available for sale securities:</b> |                   |                     |                      |            |
| Mortgage-backed securities            | \$ 8              | 1                   |                      | 9          |
| Corporate bonds                       | 14,657            | 117                 |                      | 14,774     |
| Affiliated mutual funds               | 79,975            | 6,915               | (117)                | 86,773     |
|                                       | \$ 94,640         | 7,033               | (117)                | 101,556    |
| <b>Trading securities:</b>            |                   |                     |                      |            |
| Mortgage-backed securities            |                   |                     |                      | 39         |
| Municipal bonds                       |                   |                     |                      | 500        |
| Corporate bonds                       |                   |                     |                      | 11,919     |
| Common stock                          |                   |                     |                      | 48         |
| Affiliated mutual funds               |                   |                     |                      | 82,038     |
|                                       |                   |                     |                      | 94,544     |
| Total investment securities           |                   |                     |                      | \$ 196,100 |

  

| December 31, 2012                     | Amortized<br>cost | Unrealized<br>gains | Unrealized<br>losses | Fair value |
|---------------------------------------|-------------------|---------------------|----------------------|------------|
| (in thousands)                        |                   |                     |                      |            |
| <b>Available for sale securities:</b> |                   |                     |                      |            |
| Mortgage-backed securities            | \$ 9              | 1                   |                      | 10         |
| Corporate bonds                       | 30,408            | 248                 | (3)                  | 30,653     |
| Affiliated mutual funds               | 73,443            | 3,749               | (1,090)              | 76,102     |
|                                       | \$ 103,860        | 3,998               | (1,093)              | 106,765    |
| <b>Trading securities:</b>            |                   |                     |                      |            |
| Mortgage-backed securities            |                   |                     |                      | 44         |
| Municipal bonds                       |                   |                     |                      | 501        |
| Corporate bonds                       |                   |                     |                      | 12,112     |
| Common stock                          |                   |                     |                      | 37         |
| Affiliated mutual funds               |                   |                     |                      | 56,683     |
|                                       |                   |                     |                      | 69,377     |
| Total investment securities           |                   |                     |                      | \$ 176,142 |

Purchases of trading securities during the nine months ended September 30, 2013 were \$143.4 million; \$30 million represented seed money for the Ivy Global Real Estate and Ivy Global Risk-Managed Real Estate Funds, new funds launched in the second quarter. Sales of trading securities were \$116.0 million for the same period.





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A summary of available for sale debt securities and affiliated mutual funds with fair values below carrying values at September 30, 2013 and December 31, 2012 is as follows:

| September 30, 2013                    | Less than 12 months |                   | 12 months or longer          |                   | Total      |                   |
|---------------------------------------|---------------------|-------------------|------------------------------|-------------------|------------|-------------------|
|                                       | Fair value          | Unrealized losses | Fair value<br>(in thousands) | Unrealized losses | Fair value | Unrealized losses |
| Affiliated mutual funds               | \$ 5,809            | (99)              | 212                          | (18)              | 6,021      | (117)             |
| Total temporarily impaired securities | \$ 5,809            | (99)              | 212                          | (18)              | 6,021      | (117)             |

| December 31, 2012                     | Less than 12 months |                   | 12 months or longer          |                   | Total      |                   |
|---------------------------------------|---------------------|-------------------|------------------------------|-------------------|------------|-------------------|
|                                       | Fair value          | Unrealized losses | Fair value<br>(in thousands) | Unrealized losses | Fair value | Unrealized losses |
| Corporate bonds                       | \$ 997              | (3)               |                              |                   | 997        | (3)               |
| Affiliated mutual funds               | 23,478              | (469)             | 5,604                        | (621)             | 29,082     | (1,090)           |
| Total temporarily impaired securities | \$ 24,475           | (472)             | 5,604                        | (621)             | 30,079     | (1,093)           |

Based upon our assessment of these affiliated mutual funds, the time frame investments have been in a loss position, and our intent to hold affiliated mutual funds until they have recovered, we determined that a write-down was not necessary at September 30, 2013.

Mortgage-backed securities and corporate bonds accounted for as available for sale as of September 30, 2013 mature as follows:

|                                      | Amortized cost<br>(in thousands) | Fair value |
|--------------------------------------|----------------------------------|------------|
| Within one year                      | \$ 14,657                        | 14,774     |
| After five years but within 10 years | 8                                | 9          |
|                                      | \$ 14,665                        | 14,783     |

Mortgage-backed securities, municipal bonds and corporate bonds accounted for as trading and held as of September 30, 2013 mature as follows:

|                                      | Fair value<br>(in thousands) |
|--------------------------------------|------------------------------|
| Within one year                      | \$ 11,919                    |
| After one year but within five years | 500                          |
| After five years but within 10 years | 39                           |
|                                      | \$ 12,458                    |



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Accounting standards establish a framework for measuring fair value and a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of the asset. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing the asset. An individual investment's fair value measurement is assigned a level based upon the observability of the inputs that are significant to the overall valuation. The three-tier hierarchy of inputs is summarized as follows:

- **Level 1** Investments are valued using quoted prices in active markets for identical securities.
- **Level 2** Investments are valued using other significant observable inputs, including quoted prices in active markets for similar securities.
- **Level 3** Investments are valued using significant unobservable inputs, including the Company's own assumptions in determining the fair value of investments.

Assets classified as Level 2 can have a variety of observable inputs. These observable inputs are collected and utilized, primarily by an independent pricing service, in different evaluated pricing approaches depending upon the specific asset to determine a value. The fair value of municipal bonds is measured based on pricing models that take into account, among other factors, information received from market makers and broker/dealers, current trades, bid-wants lists, offerings, market movements, the callability of the bond, state of issuance and benchmark yield curves. The fair value of corporate bonds is measured using various techniques, which consider recently executed transactions in securities of the issuer or comparable issuers, market price quotations (where observable), bond spreads and fundamental data relating to the issuer.

Securities' values classified as Level 3 are primarily determined through the use of a single quote (or multiple quotes) from dealers in the securities using proprietary valuation models. These quotes involve significant unobservable inputs, and thus, the related securities are classified as Level 3 securities.

The following tables summarize our investment securities as of September 30, 2013 and December 31, 2012 that are recognized in our consolidated balance sheets using fair value measurements based on the differing levels of inputs.

| September 30, 2013         | Level 1 | Level 2<br>(in thousands) | Level 3 | Total   |
|----------------------------|---------|---------------------------|---------|---------|
| Mortgage-backed securities | \$      | 48                        |         | 48      |
| Municipal bonds            |         | 500                       |         | 500     |
| Corporate bonds            |         | 26,693                    |         | 26,693  |
| Common stock               |         | 48                        |         | 48      |
| Affiliated mutual funds    |         | 168,811                   |         | 168,811 |
| Total                      | \$      | 168,859                   | 27,241  | 196,100 |

| December 31, 2012 | Level 1 | Level 2<br>(in thousands) | Level 3 | Total |
|-------------------|---------|---------------------------|---------|-------|
|-------------------|---------|---------------------------|---------|-------|

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|                            |    |         |         |
|----------------------------|----|---------|---------|
| Mortgage-backed securities | \$ | 54      | 54      |
| Municipal bonds            |    | 501     | 501     |
| Corporate bonds            |    | 42,765  | 42,765  |
| Common stock               |    | 37      | 37      |
| Affiliated mutual funds    |    | 132,785 | 132,785 |
| Total                      | \$ | 132,822 | 176,142 |

Table of Contents**5. Discontinued Operations**

During the third quarter of 2012, the Company committed to a plan to sell Legend. On October 29, 2012, the Company signed a definitive agreement with First Allied Holdings Inc. to sell all of the common interests of Legend Group Holdings, LLC. The sale closed effective January 1, 2013. Based on the value of the consideration the Company expected to receive upon closing of the sale, which was less than the carrying value of net assets to be sold, the Company recorded a non-cash impairment charge of \$42.4 million during the third quarter of 2012. The agreement also included an earnout provision based on asset retention for a period of two years following the closing date.

For income tax purposes, the sale resulted in a \$47.5 million capital loss that may only be utilized to offset future capital gains. Due to the character of the loss and the limited carry forward period permitted by law, the Company may not realize the full tax benefit of the capital loss.

The operational results of Legend have been presented as discontinued operations in the unaudited consolidated financial statements for the three and nine months ended September 30, 2012. Legend's revenues and loss before provision for income taxes follow:

|  | Three months<br>ended September 30, 2012<br>(in thousands) | Nine months<br>ended September 30, 2012 |
|--|--|---|
| Revenues                               | \$ 18,041  | 55,310                                  |
| Loss before provision for income taxes | \$ (43,117)  | (41,269)                                |

The assets and liabilities of Legend, classified as discontinued operations held for sale in the consolidated balance sheet at December 31, 2012, are as follows (amounts in thousands):

|   |          |
|---|----------|
| <b>Assets</b>                             |          |
| Cash and cash equivalents                 | \$ 2,303 |
| Cash and cash equivalents - restricted    | 401      |
| Investment securities                     | 1,352    |
| Receivables                               | 10,345   |
| Prepaid expenses and other current assets | 749      |
| Total current assets                      | 15,150   |
| Property and equipment, net               | 992      |
| Goodwill                                  | 16,868   |
| Other non-current assets                  | 150      |
| Total non-current assets                  | 18,010   |
| Total assets                              | 33,160   |
| <b>Liabilities</b>                        |          |
| Accounts payable                          | 464      |
| Accrued compensation                      | 6,243    |

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|                           |           |
|---------------------------|-----------|
| Other current liabilities | 880       |
| Total current liabilities | 7,587     |
| Non-current liabilities   | 281       |
| Total liabilities         | 7,868     |
| Assets less liabilities   | \$ 25,292 |

Table of Contents**6. Goodwill and Identifiable Intangible Assets**

Goodwill represents the excess of purchase price over the tangible assets and identifiable intangible assets of an acquired business. Our goodwill is not deductible for tax purposes. Goodwill and identifiable intangible assets (all considered indefinite lived) are as follows:

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
|  | (in thousands)        |                      |
| Goodwill                                     | \$ 138,947            | 138,947              |
| Accumulated amortization                     | (31,977)              | (31,977)             |
| Total goodwill                               | 106,970               | 106,970              |
| Mutual fund management advisory contracts    | 38,699                | 38,699               |
| Mutual fund management subadvisory contracts | 16,300                | 16,300               |
| Total identifiable intangible assets         | 54,999                | 54,999               |
| Total  | \$ 161,969            | 161,969              |

**7. Indebtedness**

Debt is reported at its carrying amount in the consolidated balance sheets. The fair value of the Company's outstanding indebtedness is approximately \$204.6 million at September 30, 2013 compared to the carrying value of \$190.0 million. Fair value is calculated based on Level 2 inputs.

The Company entered into a five year revolving credit facility (the "New Credit Facility") with various lenders, effective June 28, 2013, which initially provides for borrowings of up to \$125.0 million. The New Credit Facility replaced the prior credit facility, which was set to terminate in August 2013. Lenders can, at their option upon the Company's request, expand the New Credit Facility to \$200.0 million. Additionally, the New Credit Facility contains a swingline loan feature for up to \$20 million. At September 30, 2013, there were no borrowings outstanding under the facility. Borrowings under the New Credit Facility bear interest at various rates, including adjusted LIBOR or an alternative base rate plus, in each case, an incremental margin based on the Company's credit rating. The New Credit Facility also charges a facility fee on the aggregate amount of commitments under the revolving facility (whether or not utilized) based on the Company's credit rating level. The New Credit Facility's covenants match those of our \$190.0 million senior unsecured notes. The most restrictive provisions of the agreement require the Company to maintain a consolidated leverage ratio not to exceed 3.0 to 1.0 for four consecutive quarters and a consolidated interest coverage ratio of not less than 4.0 to 1.0 for four consecutive quarters. The Company was in compliance with these covenants and similar covenants in prior facilities for all periods presented.

**8. Income Tax Uncertainties**



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As of January 1, 2013 and September 30, 2013, the Company had unrecognized tax benefits, including penalties and interest, of \$10.8 million (\$7.5 million net of federal benefit) and \$12.0 million (\$8.3 million net of federal benefit), respectively, that if recognized, would impact the Company's effective tax rate. The unrecognized tax benefits that are not expected to be settled within the next 12 months are included in other liabilities in the accompanying consolidated balance sheet; unrecognized tax benefits that are expected to be settled within the next 12 months are included in income taxes payable.

The Company's accounting policy with respect to interest and penalties related to income tax uncertainties is to classify these amounts as income taxes. As of January 1, 2013, the total amount of accrued interest and penalties related to uncertain tax positions recognized in the consolidated balance sheet was \$2.5 million (\$2.0 million net of federal benefit). The total amount of penalties and interest, net of federal benefit, related to income tax uncertainties recognized in the statement of income for the nine month period ended September 30, 2013 was \$0.5 million. The total amount of accrued penalties and interest

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related to uncertain tax positions at September 30, 2013 of \$3.0 million (\$2.5 million net of federal benefit) is included in the total unrecognized tax benefits described above.

In the ordinary course of business, many transactions occur for which the ultimate tax outcome is uncertain. In addition, respective tax authorities periodically audit our income tax returns. These audits examine our significant tax filing positions, including the timing and amounts of deductions and the allocation of income among tax jurisdictions. The 2010, 2011 and 2012 federal income tax returns are open tax years that remain subject to potential future audit. State income tax returns for all years after 2009 and, in certain states, income tax returns prior to 2010, are subject to potential future audit by tax authorities in the Company's major state tax jurisdictions.

The Company is currently being audited in various state jurisdictions. It is reasonably possible that the Company will settle the audits in these jurisdictions within the next 12-month period. It is estimated that the Company's liability for unrecognized tax benefits, including penalties and interest, could decrease by up to \$3.0 million (up to \$2.0 million net of federal benefit) upon settlement of these audits. Such settlements are not anticipated to have a significant impact on the results of operations.

## 9. Pension Plan and Postretirement Benefits Other Than Pension

We provide a non-contributory retirement plan that covers substantially all employees and certain vested employees of our former parent company (the "Pension Plan"). Benefits payable under the Pension Plan are based on employees' years of service and compensation during the final 10 years of employment. We also sponsor an unfunded defined benefit postretirement medical plan that covers substantially all employees, as well as Waddell & Reed advisors. The medical plan is contributory with participant contributions adjusted annually. The medical plan does not provide for post age 65 benefits with the exception of a small group of employees that were grandfathered when such plan was established.

The components of net periodic pension and other postretirement costs related to these plans are as follows:

|  | Pension Benefits<br>Three months<br>ended<br>September 30, |         | Other<br>Postretirement<br>Benefits<br>Three months<br>ended<br>September 30, |      | Pension Benefits<br>Nine months<br>ended<br>September 30, |         | Other<br>Postretirement<br>Benefits<br>Nine months<br>ended<br>September 30, |      |
|--|--|---------|---|------|---|---------|--|------|
|  | 2013   | 2012    | 2013  | 2012 | 2013  | 2012    | 2013   | 2012 |
|  | (in thousands)   |         |   |      | (in thousands)  |         |  |      |
| Components of net periodic benefit cost: |  |         |   |      |   |         |  |      |
| Service cost                             | \$ 2,753   | 2,343   | 197   | 173  | 8,259   | 7,030   | 591  | 519  |
| Interest cost                            | 1,928  | 1,893   | 90  | 100  | 5,783   | 5,678   | 270  | 300  |
| Expected return on plan assets           | (2,796)  | (2,200) |   |      | (8,389)   | (6,600) |  |      |
| Actuarial loss amortization              | 1,142  | 1,141   |   | 3    | 3,426   | 3,422   |  | 9    |
| Prior service cost amortization          | 138  | 139     | 14  | 14   | 416   | 417     | 42   | 42   |
| Transition obligation amortization       | 1  | 1       |   |      | 3   | 4       |  |      |

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|           |    |       |       |     |     |       |       |     |     |
|-----------|----|-------|-------|-----|-----|-------|-------|-----|-----|
| Total (1) | \$ | 3,166 | 3,317 | 301 | 290 | 9,498 | 9,951 | 903 | 870 |
|-----------|----|-------|-------|-----|-----|-------|-------|-----|-----|

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(1) Net periodic pension benefit and postretirement medical costs related to discontinued operations and included in the table above were \$187 thousand for the three months ended September 30, 2012 and \$562 thousand for the nine months ended September 30, 2012.

During the first nine months of 2013, we contributed \$17.0 million to the Pension Plan. We do not expect to make additional contributions for the remainder of 2013.

Table of Contents**10. Stockholders Equity***Earnings per Share*

The components of basic and diluted earnings per share from continuing operations were as follows:

|   |    | Three months ended<br>September 30,      |        | Nine months ended<br>September 30, |         |
|---|----|--|--------|------------------------------------|---------|
|   |    | 2013                                     | 2012   | 2013                               | 2012    |
|   |    | (in thousands, except per share amounts) |        |                                    |         |
| Net income from continuing operations                               | \$ | 68,419                                   | 52,116 | 174,239                            | 140,178 |
| Weighted average shares outstanding - basic                         |    | 85,603                                   | 85,753 | 85,688                             | 85,817  |
| Dilutive potential shares from stock options                        |    |  | 2      | 1                                  | 2       |
| Weighted average shares outstanding - diluted                       |    | 85,603                                   | 85,755 | 85,689                             | 85,819  |
| Earnings per share from continuing operations,<br>basic and diluted | \$ | 0.80                                     | 0.61   | 2.03                               | 1.63    |

*Dividends*

On July 17, 2013, the Board of Directors (the Board) approved a dividend on our common stock in the amount of \$0.28 per share to stockholders of record as of October 11, 2013 to be paid on November 1, 2013. The total dividend to be paid is approximately \$23.9 million and is included in other current liabilities in the consolidated balance sheet at September 30, 2013.

*Common Stock Repurchases*

The Board has authorized the repurchase of our common stock in the open market and/or private purchases. The acquired shares may be used for corporate purposes, including shares issued to employees in our stock-based compensation programs.

There were 316,961 shares and 213,366 shares repurchased in the open market or privately during the three months ended September 30, 2013 and 2012, respectively, which included 1,961 shares and 1,966 shares repurchased from employees tendering shares to cover their minimum income tax withholdings with respect to vesting of stock awards during these two periods. There were 1,187,839 shares and 1,158,720 shares repurchased in the open market or privately during the nine months ended September 30, 2013 and 2012, respectively, which included 468,739 shares and 415,320 shares repurchased from employees tendering shares to cover their minimum income tax withholdings with respect to vesting of stock awards during each of these two periods.



Table of Contents*Accumulated Other Comprehensive Loss*

The following table summarizes other comprehensive income (loss) activity for the quarter ended September 30, 2013.

|  | Unrealized gains<br>on investment<br>securities | Change in<br>valuation<br>allowance for<br>unrealized gains<br>(losses) on<br>investment<br>securities<br>(in thousands) | Pension and<br>postretirement<br>benefits | Total<br>accumulated<br>other<br>comprehensive<br>income (loss) |
|--|---|--|---|---|
| Balance at June 30, 2013   | \$ 1,431  | (201)  | (47,214)                                  | (45,984)  |
| Other comprehensive income before<br>reclassification              | 4,330   | 2,530  |   | 6,860   |
| Amount reclassified from accumulated other<br>comprehensive income | (1,408)   | (819)  | 816                                       | (1,411)   |
| Net current period other comprehensive income                      | 2,922   | 1,711  | 816                                       | 5,449   |
| Balance at September 30, 2013                                      | \$ 4,353  | \$ 1,510   | (46,398)                                  | (40,535)  |

Reclassifications from accumulated other comprehensive income and included in net income are summarized in the table that follows for the three months ended September 30, 2013.

|  | Pre-tax  | Tax<br>(expense)<br>benefit<br>(in thousands) | Net of tax | Statement of income line item   |
|--|----------|---|------------|---|
| Reclassifications included in net<br>income:                         |          |   |            |   |
| Realized gain on sale of available for<br>sale investment securities | \$ 2,225 | (817)   | 1,408      | Investment and other income   |
| Valuation allowance  |          | 819   | 819        | Provision for income taxes  |
| Amorization of pension and<br>postretirement benefits                | (1,296)  | 480   | (816)      | Underwriting and distribution expense<br>and Compensation and related costs |
| Total  | \$ 929   | 482   | 1,411      |   |

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The following table summarizes other comprehensive income (loss) activity for the nine months ended September 30, 2013.

|  | Unrealized gains<br>on investment<br>securities | Change in<br>valuation<br>allowance for<br>unrealized gains<br>(losses) on<br>investment<br>securities<br>(in thousands) | Pension and<br>postretirement<br>benefits | Total<br>accumulated<br>other<br>comprehensive<br>income (loss) |
|--|---|--|---|---|
| Balance at December 31, 2012                                       | \$ 1,823  | 32   | (48,652)                                  | (46,797)  |
| Other comprehensive income before<br>reclassification              | 7,519   | 4,396  |   | 11,915  |
| Amount reclassified from accumulated other<br>comprehensive income | (4,989)   | (2,918)  | 2,254                                     | (5,653)   |
| Net current period other comprehensive income                      | 2,530   | 1,478  | 2,254                                     | 6,262   |
| Balance at September 30, 2013                                      | \$ 4,353  | \$ 1,510   | (46,398)                                  | (40,535)  |

Reclassifications from accumulated other comprehensive income and included in net income are summarized in the table that follows for the nine months ended September 30, 2013.

|  | Pre-tax  | Tax<br>(expense)<br>benefit<br>(in thousands) | Net of tax | Statement of income line item   |
|--|----------|---|------------|---|
| Reclassifications included in net<br>income:                         |          |   |            |   |
| Realized gain on sale of available for<br>sale investment securities | \$ 7,887 | (2,898)                                       | 4,989      | Investment and other income   |
| Valuation allowance  |          | 2,918   | 2,918      | Provision for income taxes  |
| Amorization of pension and<br>postretirement benefits                | (3,887)  | 1,633   | (2,254)    | Underwriting and distribution expense<br>and Compensation and related costs |
| Total  | \$ 4,000 | 1,653   | 5,653      |   |

## 11. Share-Based Compensation

On December 31, 2012, there were 6,371 options outstanding with a weighted average exercise price of \$21.09, all of which were exercised during 2013.

## 12. Contingencies

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The Company is involved from time to time in various legal proceedings, regulatory investigations and claims incident to the normal conduct of business, which may include proceedings that are specific to us and others generally applicable to business practices within the industries in which we operate. A substantial legal liability or a significant regulatory action against us could have an adverse effect on our business, financial condition and on the results of operations in a particular quarter or year.

The Company accrues an undiscounted liability for those contingencies where the incurrence of a loss is probable, and the amount can be reasonably estimated. These amounts are not reduced by amounts that may be recovered under insurance or claims against third parties, but undiscounted receivables from insurers or other third parties may be accrued separately. The Company regularly revises such accruals in light of new information. For contingencies where an unfavorable outcome is reasonably possible and that are significant, the Company discloses the nature of the contingency and, where feasible, an estimate of the



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possible loss. For purposes of our litigation contingency disclosures, significant includes material matters as well as other items that management believes should be disclosed. Management judgment is required related to contingent liabilities and the outcome of litigation because both are difficult to predict.

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

*This Quarterly Report on Form 10-Q contains 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, which reflect the current views and assumptions of management with respect to future events regarding our business and industry in general. These forward-looking statements include all statements, other than statements of historical fact, regarding our financial position, business strategy and other plans and objectives for future operations, including statements with respect to revenues and earnings, the amount and composition of assets under management, distribution sources, expense levels, redemption rates and the financial markets and other conditions. These statements are generally identified by the use of such words as may, could, should, would, believe, anticipate, forecast, estimate, expect, intend, plan, project, outlook, or similar words, and statements of a future or forward-looking nature. Readers are cautioned that any forward-looking information provided by or on behalf of the Company is not a guarantee of future performance. Actual results may differ materially from those contained in these forward-looking statements as a result of various factors, including but not limited to those discussed below. If one or more events related to these or other risks, contingencies or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from those forecasted or expected. Certain important factors that could cause actual results to differ materially from our expectations are disclosed in the Risk Factors section of our Annual Report on Form 10-K for the year ended December 31, 2012, which include, without limitation:*

- *The introduction of legislative or regulatory proposals or judicial rulings that change the independent contractor classification of our financial advisors at the federal or state level for employment tax or other employee benefit purposes;*
- *The adverse ruling or resolution of any litigation, regulatory investigations and proceedings, or securities arbitrations by a federal or state court or regulatory body;*
- *The loss of existing distribution channels or inability to access new distribution channels;*
- *A reduction in assets under our management on short notice, through increased redemptions in our distribution channels or our Funds, particularly those Funds with a high concentration of assets, or investors terminating their relationship with us or shifting their funds to other types of accounts with different rate structures;*
- *Our inability to implement new information technology and systems, or inability to complete such implementation in a timely or cost effective manner;*

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- *Non-compliance with applicable laws or regulations and changes in current legal, regulatory, accounting, tax or compliance requirements or governmental policies;*
- *A decline in the securities markets or in the relative investment performance of our Funds and other investment portfolios and products as compared to competing funds; and*
- *Our inability to hire and retain senior executive management and other key personnel.*

*The foregoing factors should not be construed as exhaustive and should be read together with other cautionary statements included in this and other reports and filings we make with the Securities and Exchange Commission, including the information in Item 1 Business and Item 1A Risk Factors of Part I and Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations of Part II to our Annual Report on Form 10-K for the year ended December 31, 2012 and as updated in our quarterly reports on Form 10-Q for the year ending December 31, 2013. All forward-looking statements speak only as of the date on which they are made and we undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

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**Overview**

Founded in 1937, we are one of the oldest mutual fund complexes in the United States, with expertise in a broad range of investment styles and across a variety of market environments. Our earnings and cash flows are heavily dependent on financial market conditions. Significant increases or decreases in the various securities markets can have a material impact on our results of operations, financial condition and cash flows.

We derive our revenues from providing investment management, investment product underwriting and distribution, and shareholder services administration to mutual funds and institutional and separately managed accounts. Investment management fees are based on the amount of average assets under management and are affected by sales levels, financial market conditions, redemptions and the composition of assets. Our underwriting and distribution revenues consist of commissions derived from sales of investment and insurance products, Rule 12b-1 asset-based service and distribution fees, distribution fees on certain variable products, fees earned on fee-based asset allocation products, and related advisory services. The products we sell have various commission structures and the revenues received from those sales vary based on the type and amount sold. Shareholder service fee revenue includes transfer agency fees, custodian fees from retirement plan accounts, portfolio accounting and administration fees, and is earned based on assets under management or number of client accounts. Our major expenses are underwriting and distribution-related commissions, employee compensation, amortization of deferred sales commissions, subadvisory fee expenses and information technology expense.

One of our distinctive qualities is that we are a significant distributor of investment products. Our retail products are distributed through our Wholesale channel, which includes third-parties such as other broker/dealers, registered investment advisors and various retirement platforms, or through our Advisors channel sales force of independent financial advisors. Through the Institutional Channel, we serve as sub-advisor for domestic and foreign distributors of investment products and manage investments for pension funds, Taft-Hartley plans and endowments.

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**Third Quarter Highlights**

- We internalized management of the Ivy Global Natural Resources Fund and Ivy VIP Global Natural Resources Fund effective July 2, 2013. These funds were previously subadvised by Mackenzie Financial Corporation.
- In August, we launched the following Ivy VIP Pathfinder funds (a fund of funds with Ivy VIP Funds as the underlying funds): Moderate Managed Volatility, Moderately Aggressive Managed Volatility and Moderately Conservative Managed Volatility. The addition of these funds to our portfolio enables us to include a volatility management feature within certain funds offered under the Pathfinder name, which we believe enhances our ongoing competitiveness in products we make available within variable insurance contracts.
- Income from continuing operations increased 31% compared to the third quarter of 2012, and our operating margin was 29.8%, an improvement from 27.2% for the same period a year ago.
- Our assets under management increased 9.0% during the quarter, from \$104.3 billion to \$113.7 billion, driven by market appreciation and net inflows.
- Gross sales increased 25% to \$6.8 billion for the third quarter of 2013 compared to the same period in 2012.
- Our balance sheet remains solid, and we ended the quarter with cash and investments of \$622.7 million.

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## Assets Under Management

During the third quarter, assets under management increased to \$113.7 billion compared to \$104.3 billion on June 30, 2013 due to market appreciation of \$7.9 billion and net inflows of \$1.5 billion.

### Change in Assets Under Management(1)

|                                | Wholesale | Third Quarter 2013<br>Advisors<br>(in millions) | Institutional | Total   |
|--------------------------------|-----------|---|---------------|---------|
| Beginning Assets               | \$ 53,860 | 38,172  | 12,312        | 104,344 |
| Sales and Other Net Inflows(2) | 5,191     | 1,242   | 386           | 6,819   |
| Redemptions                    | (3,723)   | (1,071)   | (550)         | (5,344) |
| Net Exchanges                  | 83        | (83)  |               | 0       |
| Net Flows                      | 1,551     | 88  | (164)         | 1,475   |
| Market Appreciation            | 4,250     | 2,507   | 1,168         | 7,925   |
| Ending Assets                  | \$ 59,661 | 40,767  | 13,316        | 113,744 |

|                                | Wholesale | Third Quarter 2012<br>Advisors<br>(in millions) | Institutional | Total   |
|--------------------------------|-----------|---|---------------|---------|
| Beginning Assets               | \$ 44,379 | 33,846  | 10,894        | 89,119  |
| Sales and Other Net Inflows(2) | 3,699     | 1,004   | 763           | 5,466   |
| Redemptions                    | (3,088)   | (1,019)   | (532)         | (4,639) |
| Net Exchanges                  | 59        | (60)  |               | (1)     |
| Net Flows                      | 670       | (75)  | 231           | 826     |
| Market Appreciation            | 2,601     | 1,603   | 660           | 4,864   |
| Ending Assets                  | \$ 47,650 | 35,374  | 11,785        | 94,809  |

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Assets under management increased to \$113.7 billion at September 30, 2013 compared to \$96.4 billion on December 31, 2012 due to market appreciation of \$12.9 billion and net inflows of \$4.5 billion.

|                                | Wholesale | Year to Date 2013<br>Advisors<br>(in millions) | Institutional | Total    |
|--------------------------------|-----------|--|---------------|----------|
| Beginning Assets               | \$ 48,930 | 35,660   | 11,775        | 96,365   |
| Sales and Other Net Inflows(2) | 15,263    | 3,949  | 1,195         | 20,407   |
| Redemptions                    | (10,863)  | (3,201)  | (1,830)       | (15,894) |
| Net Exchanges                  | 210       | (211)  |               | (1)      |
| Net Flows                      | 4,610     | 537  | (635)         | 4,512    |
| Market Appreciation            | 6,121     | 4,570  | 2,176         | 12,867   |
| Ending Assets                  | \$ 59,661 | 40,767   | 13,316        | 113,744  |

|                                | Wholesale | Year to Date 2012<br>Advisors<br>(in millions) | Institutional | Total    |
|--------------------------------|-----------|--|---------------|----------|
| Beginning Assets               | \$ 40,954 | 31,709   | 10,494        | 83,157   |
| Sales and Other Net Inflows(2) | 12,332    | 3,294  | 2,070         | 17,696   |
| Redemptions                    | (10,069)  | (3,022)  | (2,097)       | (15,188) |
| Net Exchanges                  | 3         | (6)  |               | (3)      |
| Net Flows                      | 2,266     | 266  | (27)          | 2,505    |
| Market Appreciation            | 4,430     | 3,399  | 1,318         | 9,147    |
| Ending Assets                  | \$ 47,650 | 35,374   | 11,785        | 94,809   |

(1) Includes all activity of the Funds and institutional and separate accounts, including money market funds and transactions at net asset value, accounts for which we receive no commissions.

(2) Sales and Other Net Inflows is primarily gross sales (net of sales commission). This amount also includes net reinvested dividends and capital gains and investment income.

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Average assets under management, which are generally more indicative of trends in revenue for providing investment management services than the quarter over quarter change in ending assets under management, are presented below.

*Average Assets Under Management*

|              | Wholesale | Third Quarter 2013<br>Advisors Institutional<br>(in millions) |        | Total      |
|--------------|-----------|---|--------|------------|
| Asset Class: |           |   |        |            |
| Equity       | \$ 45,696 | 29,027  | 12,277 | \$ 87,000  |
| Fixed Income | 11,303    | 9,151   | 565    | 21,019     |
| Money Market | 197       | 1,672   |        | 1,869      |
| Total        | \$ 57,196 | 39,850  | 12,842 | \$ 109,888 |

|              | Wholesale | Third Quarter 2012<br>Advisors Institutional<br>(in millions) |        | Total     |
|--------------|-----------|---|--------|-----------|
| Asset Class: |           |   |        |           |
| Equity       | \$ 37,381 | 24,221  | 10,699 | \$ 72,301 |
| Fixed Income | 8,374     | 9,164   | 788    | 18,326    |
| Money Market | 174       | 1,304   |        | 1,478     |
| Total        | \$ 45,929 | 34,689  | 11,487 | \$ 92,105 |

|              | Wholesale | Year to Date 2013<br>Advisors Institutional<br>(in millions) |        | Total      |
|--------------|-----------|--|--------|------------|
| Asset Class: |           |  |        |            |
| Equity       | \$ 43,162 | 27,573   | 11,922 | \$ 82,657  |
| Fixed Income | 11,008    | 9,481  | 699    | 21,188     |
| Money Market | 180       | 1,483  |        | 1,663      |
| Total        | \$ 54,350 | 38,537   | 12,621 | \$ 105,508 |

|              | Wholesale | Year to Date 2012<br>Advisors Institutional<br>(in millions) |        | Total     |
|--------------|-----------|--|--------|-----------|
| Asset Class: |           |  |        |           |
| Equity       | \$ 37,958 | 24,135   | 10,583 | \$ 72,676 |
| Fixed Income | 7,049     | 8,789  | 780    | 16,618    |
| Money Market | 195       | 1,309  |        | 1,504     |
| Total        | \$ 45,202 | 34,233   | 11,363 | \$ 90,798 |

Table of Contents**Results of Operations Three and Nine Months Ended September 30, 2013 as Compared with Three and Nine Months Ended September 30, 2012***Income from continuing operations*

|  |    | <b>Three months ended<br/>September 30,<br/>2013</b> | <b>2012</b> | <b>Variance</b> |
|--|----|--|-------------|-----------------|
| Income from continuing operations                              | \$ | 68,419   | 52,116      | 31%             |
| Income per share from continuing operations, basic and diluted | \$ | 0.80   | 0.61        | 31%             |
| Operating Margin   |    | 29.8%  | 27.2%       | 10%             |

|  |    | <b>Nine months ended<br/>September 30,<br/>2013</b> | <b>2012</b> | <b>Variance</b> |
|--|----|---|-------------|-----------------|
| Income from continuing operations                              | \$ | 174,239   | 140,178     | 24%             |
| Income per share from continuing operations, basic and diluted | \$ | 2.03  | 1.63        | 25%             |
| Operating Margin   |    | 27.2%   | 25.2%       | 8%              |

The Company sold its Legend group of subsidiaries ( Legend ) effective January 1, 2013. The operational results of Legend have been reclassified as discontinued operations in the unaudited consolidated financial statements for the three and nine months ended September 30, 2012. Unless stated otherwise, any reference to income statement items refers to results from continuing operations.

We reported net income from continuing operations of \$68.4 million, or \$0.80 per diluted share, for the third quarter of 2013 compared to \$52.1 million, or \$0.61 per diluted share, for the third quarter of 2012.

For the nine months ended September 30, 2013, net income from continuing operations was \$174.2 million, or \$2.03 per diluted share, compared to \$140.2 million, or \$1.63 per diluted share, for the nine months ended September 30, 2012.

During the second quarter of 2013, we completed the initial public offering of our first closed-end mutual fund, the Ivy High Income Opportunities Fund. We incurred one-time pre-tax expenses of \$8.6 million, recorded in underwriting and distribution and general and administrative expenses. These items will be discussed in the related sections that follow.



*Total Revenues*

Total revenues increased 18% to \$347.1 million for the three months ended September 30, 2013 compared to the three months ended September 30, 2012 due to an increase in average assets under management of 19% and an increase in gross sales of 25%. For the nine months ended September 30, 2013, total revenues increased \$124.4 million, or 14%, compared to the same period in the prior year due to an increase in average assets under management of 16% and an increase in gross sales of 15%.

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|                                    |    | Three months ended<br>September 30,    |         |          |
|------------------------------------|----|--|---------|----------|
|                                    |    | 2013                                   | 2012    | Variance |
|                                    |    | (in thousands, except percentage data) |         |          |
| Investment management fees         | \$ | 165,559                                | 138,364 | 20%      |
| Underwriting and distribution fees |    | 146,863                                | 122,819 | 20%      |
| Shareholder service fees           |    | 34,667                                 | 32,182  | 8%       |
| Total revenues                     | \$ | 347,089                                | 293,365 | 18%      |

|                                    |    | Nine months ended<br>September 30,     |         |          |
|------------------------------------|----|--|---------|----------|
|                                    |    | 2013                                   | 2012    | Variance |
|                                    |    | (in thousands, except percentage data) |         |          |
| Investment management fees         | \$ | 470,223                                | 407,477 | 15%      |
| Underwriting and distribution fees |    | 423,879                                | 367,659 | 15%      |
| Shareholder service fees           |    | 101,248                                | 95,786  | 6%       |
| Total revenues                     | \$ | 995,350                                | 870,922 | 14%      |

*Investment Management Fee Revenues*

Investment management fee revenues are earned for providing investment advisory services to the Funds and to institutional and separate accounts. Investment management fee revenues increased \$27.2 million, or 20%, from last year's third quarter. For the nine month period ended September 30, 2013, investment management fee revenues increased \$62.7 million, or 15%, compared to the same period in 2012.

Revenues from investment management services provided to our retail mutual funds, which are distributed through the Wholesale, Advisors and Institutional channels, were \$153.8 million for the quarter ended September 30, 2013. Revenues increased \$26.3 million, or 21%, compared to the third quarter of 2012, while the related retail average assets increased 20% to \$97.0 billion. Investment management fee revenues increased more than the related retail average assets due to a shift in assets to products with higher management fee rates. For the nine months ended September 30, 2013, revenues from investment management services provided to our retail mutual funds were \$435.0 million. Revenues increased \$59.7 million, or 16%, compared to the first nine months of 2012, while the related retail average assets increased 17% to \$92.9 billion. Investment management fee revenues increased less than the related retail average assets due in part to one less day in the first nine months of 2013 compared to 2012, as well as a shift in assets toward products with lower than average management fee rates.

Institutional account revenues were \$11.8 million for the third quarter of 2013, representing an increase of \$0.9 million, or 9%, from the third quarter of 2012, while average assets increased 12%. For the nine month period ended September 30, 2013, institutional account revenues were \$35.2 million, an increase of 9% compared to the same period in 2012, and average assets increased 11%. For both periods, account revenues increased less than the related average assets due to a decline in the average management fee rate.

Long-term redemption rates (which exclude money market fund redemptions) in the Wholesale channel were 25.7% in the third quarter of 2013 and 26.6% year-to-date, compared to 26.6% in the third quarter of 2012 and 30.0% for the first nine months of 2012. In the Advisors channel, long-term redemption rates were 8.7% for the quarter ended September 30, 2013 compared to 9.7% in the third quarter of 2012. For the nine months ended September 30, 2013, the Advisor's channel long-term redemption rate decreased to 9.1% compared to 9.7% for the same period in 2012. We expect the Advisors channel long-term redemption rate to remain lower than that of the industry average due to the personal and

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customized nature in which our financial advisors provide service to our clients. Long-term redemption rates for our Institutional channel were 17.0% and 18.4% for the third quarter of 2013 and 2012, respectively, and 19.4% for the nine month period ended September 30, 2013 compared to 24.7% for the same period in 2012.

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Our overall redemption rate of 19.4% for the first nine months of 2013 compares positively to the current year to date industry average of approximately 26%, based on data from the Investment Company Institute.

*Underwriting and Distribution Fee Revenues and Expenses*

The following tables summarize our underwriting and distribution fee revenues and expenses segregated by distribution method within the respective Wholesale or Advisors channel:

|                                 | Wholesale   | Third Quarter 2013<br>Advisors<br>(in thousands) | Total     |
|---------------------------------|-------------|--|-----------|
| Revenue                         | \$ 52,472   | 94,391   | 146,863   |
| Expenses - Direct               | (67,107)    | (64,550)   | (131,657) |
| Expenses - Indirect             | (10,409)    | (26,980)   | (37,389)  |
| Net Distribution (Costs)/Excess | \$ (25,044) | 2,861  | (22,183)  |

|                          | Wholesale   | Third Quarter 2012<br>Advisors<br>(in thousands) | Total     |
|--------------------------|-------------|--|-----------|
| Revenue                  | \$ 44,659   | 78,160   | 122,819   |
| Expenses - Direct        | (57,390)    | (54,246)   | (111,636) |
| Expenses - Indirect      | (10,045)    | (25,727)   | (35,772)  |
| Net Distribution (Costs) | \$ (22,776) | (1,813)  | (24,589)  |

|                                 | Wholesale   | Year to Date 2013<br>Advisors<br>(in thousands) | Total     |
|---------------------------------|-------------|---|-----------|
| Revenue                         | \$ 150,493  | 273,386   | 423,879   |
| Expenses - Direct               | (195,349)   | (187,001)                                       | (382,350) |
| Expenses - Indirect             | (32,638)    | (80,473)  | (113,111) |
| Net Distribution (Costs)/Excess | \$ (77,494) | 5,912   | (71,582)  |

|                          | Wholesale   | Year to Date 2012<br>Advisors<br>(in thousands) | Total     |
|--------------------------|-------------|---|-----------|
| Revenue                  | \$ 133,040  | 234,619   | 367,659   |
| Expenses - Direct        | (167,781)   | (163,735)                                       | (331,516) |
| Expenses - Indirect      | (29,596)    | (78,849)  | (108,445) |
| Net Distribution (Costs) | \$ (64,337) | (7,965)   | (72,302)  |

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Underwriting and distribution revenues earned in the third quarter of 2013 increased \$24.0 million, or 20%, compared with the third quarter of 2012 due to increased revenues in our Advisors channel of \$16.2 million, and increased revenues in our Wholesale channel of \$7.8 million. Rule 12b-1 asset-based service and distribution fee revenues increased \$10.3 million, or 16%, due to an increase in average mutual fund assets under management. Revenues from fee-based asset allocation products increased \$10.0 million

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compared to the prior year, as assets grew from \$9.6 billion at September 30, 2012 to \$13.0 billion at September 30, 2013. Variable annuity revenues increased \$1.1 million.

For the nine months ended September 30, 2013, underwriting and distribution revenues increased \$56.2 million, or 15%, compared with the nine months ended September 30, 2012. The increase was comprised of an increase in the Advisors channel of \$38.8 million and a \$17.4 million increase in Wholesale channel revenues period over period. Revenues from fee-based asset allocation products increased \$27.5 million compared to the prior year. Rule 12b-1 asset-based service and distribution fee revenues increased \$24.6 million, or 13%, due to an increase in average mutual fund assets under management. E&O insurance premiums collected from our advisors increased revenues \$2.1 million. Prior to the first quarter of 2013, these premiums were netted in operating expenses. Revenues from front load product sales increased \$1.5 million. Partially offsetting the above increases, variable annuity revenues decreased \$2.0 million compared to the prior year and insurance revenues decreased \$1.1 million.

Underwriting and distribution expenses increased by \$21.6 million, or 15%, compared to the third quarter of 2012. Direct expenses in the Wholesale channel increased by \$9.7 million as a result of an increase in average wholesale assets under management and higher sales volume year over year. We incurred higher dealer compensation paid to third-party distributors, increased Rule 12b-1 asset-based service and distribution expenses and higher wholesaler commissions. Direct expenses in the Advisors channel increased \$10.3 million, or 19%, compared to the third quarter of 2012 due to increased advisory fees related to the increase in fee-based asset allocation products of \$7.7 million and increased Rule 12b-1 asset-based service and distribution expenses of \$1.5 million. Commissions on variable annuity product sales increased \$0.5 million. Indirect expenses increased \$1.6 million compared to the quarter ended September 30, 2012 primarily due to increased convention and computer services expenses.

For the nine months ended September 30, 2013, underwriting and distribution expenses increased by \$55.5 million, or 13%, compared to the first nine months of 2012. Direct expenses in the Wholesale channel increased by \$27.6 million. The second quarter of 2013 included \$1.8 million of underwriting and distribution expenses associated with the launch of the Ivy High Income Opportunities closed-end fund. Excluding the closed-end fund costs, underwriting and distribution expenses in the Wholesale channel increased \$25.8 million compared to the first nine months of 2012, due to increased dealer compensation paid to third-party distributors, increased Rule 12b-1 asset-based service and distribution expenses and higher wholesaler commissions as a result of an increase in average wholesale assets under management and higher sales volume year over year. Direct expenses in the Advisors channel increased \$23.2 million, or 14%, compared to 2012 due to increased advisory fees related to the increase in fee-based asset allocation products of \$20.5 million and increased Rule 12b-1 asset-based service and distribution expenses of \$3.1 million. These increases were partially offset by decreased commissions on variable annuity product sales of \$1.4 million and a decrease in insurance commission expense of \$0.6 million. For the nine months ended September 30, 2013, indirect expenses increased \$4.7 million compared to the same period in 2012 primarily due to higher computer services and software costs, higher convention costs, higher marketing costs and increased employee compensation and benefits expense.

## *Shareholder Service Fee Revenue*

Shareholder service fee revenue primarily includes transfer agency fees, custodian fees from retirement plan accounts, and portfolio accounting and administration fees. Transfer agency fees and portfolio accounting and administration fees are asset-based revenues or account-based revenues, while custodian fees from retirement plan accounts are based on the number of client accounts. During the third quarter of 2013, shareholder service fee revenue increased \$2.5 million, or 8%, over the third quarter of 2012, due to higher asset-based fees quarter over quarter in certain share classes. For the nine month period ended September 30, 2013, shareholder service fee revenue increased \$5.5 million, or 6%, compared to the same period in 2012. Of the total increase, revenues increased \$6.2 million due to higher asset-based fees in certain share classes and account-based fees increased \$1.3. The increase in account based fees was offset by a decrease of \$1.9 million in technology reimbursements from the Funds due to lower rates negotiated during the renewal of a vendor contract effective the beginning of 2013. For the

nine month period ended September 30, 2013, the number of accounts increased 1% compared to the same period in 2012.

Table of Contents*Total Operating Expenses*

Operating expenses increased \$30.2 million, or 14%, in the third quarter of 2013 compared to the third quarter of 2012, primarily due to increased underwriting and distribution expenses and compensation and related costs. For the nine months ended September 30, 2013, operating expenses increased \$72.3 million, or 11%, compared to the first nine months of 2012, primarily due to increased underwriting and distribution expenses, compensation and related costs, and general and administrative expenses. Underwriting and distribution expenses are discussed above.

|                                | <b>Three Months Ended<br/>September 30,</b>   |             | <b>Variance</b> |
|--------------------------------|---|-------------|-----------------|
|                                | <b>2013</b>                                   | <b>2012</b> |                 |
|                                | <b>(in thousands, except percentage data)</b> |             |                 |
| Underwriting and distribution  | \$ 169,046                                    | 147,408     | 15%             |
| Compensation and related costs | 49,472  | 42,343      | 17%             |
| General and administrative     | 20,462  | 15,774      | 30%             |
| Subadvisory fees               | 1,667   | 4,921       | -66%            |
| Depreciation                   | 3,172   | 3,188       | -1%             |
| Total operating expenses       | \$ 243,819                                    | 213,634     | 14%             |

|                                | <b>Nine Months Ended<br/>September 30,</b>    |             | <b>Variance</b> |
|--------------------------------|---|-------------|-----------------|
|                                | <b>2013</b>                                   | <b>2012</b> |                 |
|                                | <b>(in thousands, except percentage data)</b> |             |                 |
| Underwriting and distribution  | \$ 495,461                                    | 439,961     | 13%             |
| Compensation and related costs | 145,003                                       | 128,432     | 13%             |
| General and administrative     | 63,608  | 57,172      | 11%             |
| Subadvisory fees               | 10,442  | 16,400      | -36%            |
| Depreciation                   | 9,621   | 9,876       | -3%             |
| Total operating expenses       | \$ 724,135                                    | 651,841     | 11%             |

*Compensation and Related Costs*

Compensation and related costs increased \$7.1 million, or 17%, compared to the third quarter of 2012. Of the total increase period over period, incentive compensation increased \$3.6 million, while base salaries increased \$1.4 million due to increased headcount and annual salary increases. Share-based compensation increased \$1.9 million due to higher amortization expense associated with our April 2013 and December 2012 grants of nonvested stock compared to grants that became fully vested in 2012 and an increase in non-employee advisor (independent contractor) stock award amortization expense.

For the nine months ended September 30, 2013, compensation and related costs increased \$16.6 million, or 13%, compared to the first nine months of 2012. Incentive compensation increased \$7.5 million, while base salaries increased \$4.7 million associated with increased headcount and annual salary increases. Share-based compensation increased \$3.0 million, which included the impact of a credit taken in 2013 related to the cancellation of unvested shares granted to Legend employees and Legend advisors. The share-based compensation increase is due to higher amortization expense associated with our April 2013 and December 2012 grants of nonvested stock compared to grants that became fully vested in 2012 and an increase in non-employee advisor stock award amortization expense. Group insurance costs increased \$0.8 million based on unfavorable claims experience. Partially offsetting these increases, capitalized software development activities increased \$0.8 million.





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*General and Administrative Costs*

General and administrative expenses increased \$4.7 million to \$20.5 million for the third quarter of 2013 compared to the third quarter of 2012. During the third quarter of 2012, we recorded an adjustment of \$3.5 million to reflect lower estimated costs of distributing an SEC market timing settlement dating back to 2006, and a reduction in the estimated legal costs related to an ongoing class action suit. Excluding these items in 2012, general and administrative costs increased \$1.2 million due to increased dealer services costs based on higher asset levels in certain share classes and increased costs for temporary office staff, partially offset by lower legal costs.

For the nine months ended September 30, 2013, general and administrative expenses increased \$6.4 million compared to the same period in 2012. Included in the second quarter of 2013 were one-time structuring, offering and organizational costs for the launch of the Ivy High Income Opportunities Fund in the amount of \$6.7 million. During the second quarter of 2012, we recorded a pre-tax charge of \$5.0 million to reflect the impairment of certain capitalized software development costs. Excluding the \$6.7 million charge recorded in 2013, the \$5.0 million charge recorded in 2012 and the \$3.5 million adjustment in 2012 described above, general and administrative expenses increased \$1.2 million, due to higher dealer service costs, higher costs incurred for our national branding campaign and higher temporary office staff expenses, offset by lower legal and computer service and software costs.

*Subadvisory Fees*

Subadvisory fees represent fees paid to other asset managers for providing advisory services for certain mutual fund portfolios. These expenses reduce our operating margin since we pay out approximately half of our management fee revenue received from subadvised products. Gross management fee revenues for products subadvised by others were \$3.2 million for the three months ended September 30, 2013 compared to \$9.8 million for the third quarter of 2012 due to a 61% decrease in average net assets. For the nine months ended September 30, 2013, gross management fee revenues for products subadvised by others were \$20.6 million compared to \$32.6 million for the same period in 2012 due to a 13% decrease in average net assets. The decrease in average net assets is a result of internalizing the management of the Global Natural Resources funds after the portfolio manager's retirement from Mackenzie Financial Corporation, the subadvisor, during the third quarter of 2013. Subadvisory expenses followed the same pattern of decrease compared to 2012.

*Other Income and Expenses*

*Investment and Other Income, Interest Expense and Taxes*

Investment and other income was \$5.2 million for the quarter ended September 30, 2013, compared to \$2.6 million in the same period a year ago. We recorded realized gains of \$2.2 million on the sale of available for sale mutual fund holdings during the current quarter compared to \$1.2 million in the third quarter of 2012. In our mutual fund trading portfolio, we recorded mark-to-market gains of \$2.8 million during the quarter compared to gains of \$1.8 million for the three months ended September 30, 2012. Included in the current year's third quarter was a \$1.1 million loss related to the Company's investment in limited partnerships compared to a loss of \$1.2 million in the third quarter of 2012. We recorded mutual fund dividend income of \$0.4 million during the current quarter compared to \$0.2 million in the third quarter of 2012.

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For the nine months ended September 30, 2013 and 2012, investment and other income was \$10.6 million and \$7.9 million, respectively. We recorded realized gains of \$7.9 million on the sale of available for sale mutual fund holdings during the first nine months of 2013, compared to \$2.9 million during the first nine months of 2012. In our mutual fund trading portfolio, we recorded mark-to-market gains of \$2.9 million in 2013, compared to gains of \$4.7 million in 2012. The first nine months of 2013 included a \$2.9 million loss related to the Company's investment in limited partnerships compared to a loss of \$1.5 million for the same period in 2012. We recorded mutual fund dividend income of \$1.0 million during the first nine months of 2013 compared to \$0.3 million in the first nine months of 2012.

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Interest expense was \$2.8 million for the three month periods ended September 30, 2013 and 2012 and \$8.5 million for the nine month periods ended September 30, 2013 and 2012.

Our effective income tax rate from continuing operations was 35.2% for the third quarter of 2013, as compared to 34.5% for the third quarter of 2012. Due to the sale of a subsidiary in 2013, the Company has deferred tax assets related to capital loss carryforwards, which are available to offset current and future capital gains. A valuation allowance was recorded on this capital loss when realized due to the extent that this loss exceeded available capital gains. The valuation allowance was necessary due to the limited carryforward period permitted by law on losses of this character. An increase in the fair value of the Company's trading securities portfolio and realized capital gains on securities classified as available for sale in the third quarter of 2013 allowed for a release of the valuation allowance, thereby reducing income tax expense by \$1.9 million. Realized capital gains on securities classified as available for sale and an increase in the fair value of the Company's trading securities portfolio in the third quarter of 2012 allowed for a release of the valuation allowance, thereby reducing income tax expense by \$1.0 million.

The third quarter 2013 and 2012 effective income tax rates for continuing operations, removing the effects of the valuation allowance, would have been 37.1% and 35.7%, respectively. The adjusted effective tax rate in the third quarter of 2012 was lower primarily due to an adjustment to a deferred tax asset to more accurately reflect future tax benefits as well as the expiration of the statute of limitations on uncertain tax positions.

Our effective income tax rate was 36.2% for the nine months ended September 30, 2013, as compared to 35.8% for the nine months ended September 30, 2012. The effective tax rate was lower for the nine months ended September 30, 2012 primarily due to an adjustment to a deferred tax asset to more accurately reflect future tax benefits as well as the expiration of the statute of limitations on uncertain tax positions.

The Company expects its future effective tax rate, exclusive of any increases or reductions to the valuation allowance, state tax incentives, unanticipated state tax legislative changes, and unanticipated fluctuations in earnings to range from 37% to 39%.

**Liquidity and Capital Resources**

Our operations provide much of the cash necessary to fund our priorities, as follows:

- Finance internal growth
- Pay dividends
- Repurchase our stock

*Finance Internal Growth*

We use cash to fund growth in our distribution channels. Our Wholesale channel, which has a higher cost to gather assets, requires cash outlays for wholesaler commissions and commissions to third parties on deferred load product sales. We continue to invest in our Advisors channel by providing additional support to our advisors through home office resources, wholesaling efforts and enhanced technology tools.

*Pay Dividends*

We paid quarterly dividends on our common stock that resulted in financing cash outflows of \$72.1 million and \$64.5 million for the first nine months of 2013 and 2012, respectively.

*Repurchase Our Stock*

We repurchased 1,187,839 shares and 1,158,720 shares of our common stock in the open market or privately during the nine months ended September 30, 2013 and 2012, respectively, resulting in cash outflows of \$52.5 million and \$36.0 million, respectively.

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**Operating Cash Flows**

Cash from operations, our primary source of funds, increased \$31.0 million for the nine months ended September 30, 2013 compared to the previous year. The increase is partially due to decreased purchases of trading securities in the first nine months of 2013 compared to the same period in 2012.

During the first nine months of 2013, we contributed \$17.0 million to the Pension Plan. We do not expect to make additional contributions for the remainder of the year.

**Investing Cash Flows**

Investing activities consist primarily of the purchase, sale and maturities of available for sale investment securities, as well as capital expenditures. We expect our 2013 capital expenditures to be in the range of \$15.0 to \$20.0 million. Related to the sale of Legend, we received cash proceeds of \$22.0 million during the first quarter of 2013.

**Financing Cash Flows**

As noted previously, dividends and stock repurchases accounted for a majority of our financing cash outflows in the first nine months of 2013 and 2012.

**Future Capital Requirements**

Management believes its available cash, marketable securities and expected cash flow from operations will be sufficient to fund its short-term operating and capital requirements. Expected short-term uses of cash include dividend payments, interest payments on outstanding debt, income tax payments, seed money for new products, share repurchases, payment of deferred commissions to our financial advisors and third-parties, capital expenditures and home office leasehold improvements, and could include strategic acquisitions.

Expected long-term capital requirements include indebtedness, operating leases and purchase obligations, and potential recognition of tax liabilities. Other possible long-term discretionary uses of cash could include capital expenditures for enhancement of technology infrastructure and home office expansion, strategic acquisitions, payment of dividends, income tax payments, seed money for new products, payment of upfront fund commissions for Class B shares, Class C shares and certain fee-based asset allocation products, pension funding and repurchases of our common stock.

**Critical Accounting Policies and Estimates**

Management believes certain critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements. The Company's critical accounting policies and estimates are disclosed in the Critical Accounting Policies and Estimates section of our 2012 Form 10-K.

Our indefinite life intangible asset balance includes \$16.3 million related to our subadvisory agreement to manage certain mutual fund products for Mackenzie Financial Corporation ( MFC ) recorded in connection with our purchase of Mackenzie Investment Management, Inc. in 2002. As part of purchase accounting, a deferred tax liability was established related to this identifiable intangible asset. As of September 30, 2013, the associated deferred tax liability is \$6.1 million.

The fair value of this intangible asset exceeded its carrying amount by 20% when performing our annual testing for impairment during the second quarter. Based on the result of our annual test, we increased the frequency of our impairment analysis for this asset, and there are no indicators of impairment as of September 30, 2013.

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|  | Third<br>Quarter<br>2013 | Third<br>Quarter<br>2012 | Change | Year to<br>Date<br>2013 | Year to<br>Date<br>2012 | Change |
|--|--------------------------|--------------------------|--------|-------------------------|-------------------------|--------|
| <u>Channel highlights</u>                                  |                          |                          |        |                         |                         |        |
| Number of Wholesalers                                      | 49                       | 50                       | -2.0%  | 49                      | 50                      | -2.0%  |
| Number of Advisors   | 1,784                    | 1,753                    | 1.8%   | 1,784                   | 1,753                   | 1.8%   |
| Gross revenue per advisor (in thousands)                   | \$ 49.7                  | 41.4                     | 20.0%  | \$ 146.0                | 123.9                   | 17.8%  |
| <u>Redemption rates - long term assets</u>                 |                          |                          |        |                         |                         |        |
| Wholesale  | 25.7%                    | 26.6%                    |        | 26.6%                   | 30.0%                   |        |
| Advisors   | 8.7%                     | 9.7%                     |        | 9.1%                    | 9.7%                    |        |
| Institutional  | 17.0%                    | 18.4%                    |        | 19.4%                   | 24.7%                   |        |
| Total  | 18.6%                    | 19.3%                    |        | 19.4%                   | 21.6%                   |        |
| <u>Operating highlights</u>                                |                          |                          |        |                         |                         |        |
| Organic growth annualized                                  | 5.7%                     | 3.7%                     |        | 6.2%                    | 4.0%                    |        |
| Total assets under management (in millions)                | \$ 113,744               | 94,809                   | 20.0%  | \$ 113,744              | 94,809                  | 20.0%  |
| Operating Margin   | 29.8%                    | 27.2%                    |        | 27.2%                   | 25.2%                   |        |
| <u>Diversification (Company Total)</u>                     |                          |                          |        |                         |                         |        |
| <u>As % of Sales</u>                                       |                          |                          |        |                         |                         |        |
| Asset Strategy   | 25.9%                    | 21.1%                    |        | 29.3%                   | 26.0%                   |        |
| Fixed Income   | 31.8%                    | 39.4%                    |        | 31.0%                   | 34.0%                   |        |
| Other  | 42.3%                    | 39.5%                    |        | 39.7%                   | 40.0%                   |        |
| <u>As % of Assets Under Management</u>                     |                          |                          |        |                         |                         |        |
| Asset Strategy   | 33.8%                    | 33.6%                    |        | 33.8%                   | 33.6%                   |        |
| Fixed Income   | 19.0%                    | 20.2%                    |        | 19.0%                   | 20.2%                   |        |
| Other  | 47.2%                    | 46.2%                    |        | 47.2%                   | 46.2%                   |        |
| <u>Shareholder service fees</u>                            |                          |                          |        |                         |                         |        |
| Average assets for I, Y, and R share classes (in millions) | \$ 24,207                | 18,183                   | 33.1%  | \$ 22,704               | 17,741                  | 28.0%  |
| Number of shareholder accounts (in thousands)              | 4,237                    | 4,179                    | 1.4%   | 4,237                   | 4,179                   | 1.4%   |



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

The Company has had no significant changes in its Quantitative and Qualitative Disclosures About Market Risk from that previously reported in the Company's 2012 Form 10-K.

**Item 4. Controls and Procedures**

The Company maintains a system of disclosure controls and procedures that is designed to provide reasonable assurance that information, which is required to be timely disclosed, is accumulated and communicated to management in a timely fashion. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The Company's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this quarterly report, have concluded that the Company's disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure and are effective to provide reasonable assurance that such information is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

The Company's internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) is 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. There were no changes in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. However, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

Table of Contents**Part II. Other Information****Item 1. Legal Proceedings**

The Company is involved from time to time in various legal proceedings, regulatory investigations and claims incident to the normal conduct of business, which may include proceedings that are specific to us and others generally applicable to the business practices within the industries in which we operate. A substantial legal liability or a significant regulatory action against us could have an adverse effect on our business, financial condition and on the results of operations in a particular quarter or year.

**Item 1A. Risk Factors**

The Company has had no material changes to its Risk Factors from those previously reported in the Company's 2012 Form 10-K.

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

The following table sets forth certain information about the shares of common stock we repurchased during the third quarter of 2013.

| Period                     | Total Number<br>of Shares<br>Purchased (1) | Average<br>Price Paid<br>Per Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Program | Maximum Number (or<br>Approximate Dollar<br>Value) of Shares that<br>May Yet Be Purchased<br>Under the Program |
|----------------------------|--|------------------------------------|---|--|
| July 1 - July 31           | 116,821                                    | \$ 50.36                           | 116,821   | n/a(1)   |
| August 1 - August 31       | 165,140                                    | 49.35                              | 165,140   | n/a(1)   |
| September 1 - September 30 | 35,000                                     | 47.71                              | 35,000  | n/a(1)   |
| Total                      | 316,961                                    | \$ 49.54                           | 316,961   |  |

(1) On August 31, 1998, we announced that our Board of Directors approved a program to repurchase shares of our common stock on the open market. Under the repurchase program, we are authorized to repurchase, in any seven-day period, the greater of (i) 3% of our outstanding common stock or (ii) \$50 million of our common stock. We may repurchase our common stock through the New York Stock Exchange, other national or regional market systems, electronic communication networks or alternative trading systems. Our stock repurchase program does not have an expiration date or an aggregate maximum number or dollar value of shares that may be repurchased. Our Board of Directors reviewed and ratified the stock repurchase program in October 2012. During the third quarter of 2013, all stock repurchases were made pursuant to the repurchase program and 1,961 shares, reflected in the table above, were purchased in connection with funding employee income tax withholding obligations arising from the vesting of nonvested shares.



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**Item 6. Exhibits**

31.1 Section 302 Certification of Chief Executive Officer

31.2 Section 302 Certification of Chief Financial Officer

32.1 Section 906 Certification of Chief Executive Officer

32.2 Section 906 Certification of Chief Financial Officer

101 Materials from the Waddell & Reed Financial, Inc. Quarterly Report on Form 10-Q for the quarter ended September 30, 2013, formatted in Extensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statement of Stockholders' Equity, (v) Consolidated Statements of Cash Flows, and (vi) related Notes to the Unaudited Consolidated Financial Statements, tagged in detail.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 1st day of November 2013.

**WADDELL & REED FINANCIAL, INC.**

By: /s/ Henry J. Herrmann  
Chief Executive Officer, Chairman of the Board and  
Director  
(Principal Executive Officer)

By: /s/ Daniel P. Connealy  
Senior Vice President  
and Chief Financial Officer  
(Principal Financial Officer)

By: /s/ Brent K. Bloss  
Senior Vice President - Finance  
and Treasurer  
(Principal Accounting Officer)