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SEI INVESTMENTS CO

Form 10-Q

October 26, 2017

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)*

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the quarterly period ended September 30, 2017

or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

**for the transition period from _____ to _____
0-10200**

(Commission File Number)

SEI INVESTMENTS COMPANY

(Exact name of registrant as specified in its charter)

Pennsylvania 23-1707341

**(State or other jurisdiction of (IRS Employer
incorporation or organization) Identification Number)**

1 Freedom Valley Drive, Oaks, Pennsylvania 19456-1100

(Address of principal executive offices)

(Zip Code)

(610) 676-1000

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer Accelerated filer

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

Emerging growth company

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

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

The number of shares outstanding of the registrant's common stock as of October 19, 2017 was 157,473,146.

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PART I. FINANCIAL INFORMATION**Item 1. Consolidated Financial Statements.****SEI Investments Company****Consolidated Balance Sheets***(unaudited)**(In thousands, except par value)*

	September 30, 2017	December 31, 2016
<u>Assets</u>		
Current Assets:		
Cash and cash equivalents	\$684,971	\$695,701
Restricted cash	3,503	3,500
Receivables from investment products	50,961	61,761
Receivables, net of allowance for doubtful accounts of \$699 and \$523	273,535	227,957
Securities owned	21,469	21,339
Other current assets	30,537	27,575
Total Current Assets	1,064,976	1,037,833
Property and Equipment, net of accumulated depreciation of \$302,901 and \$285,322	148,106	146,190
Capitalized Software, net of accumulated amortization of \$340,864 and \$303,540	307,116	295,867
Investments Available for Sale	82,252	84,033
Investments in Affiliated Funds, at fair value	5,738	4,858
Investment in Unconsolidated Affiliate	42,225	50,459
Intangible Assets, net	82,263	—
Deferred Income Taxes	1,676	2,127
Other Assets, net	17,045	15,456
Total Assets	\$1,751,397	\$1,636,823

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

SEI Investments Company
Consolidated Balance Sheets

(unaudited)

(In thousands, except par value)

Liabilities and Equity

Current Liabilities:

Accounts payable	\$4,429	\$5,966
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Accrued liabilities	185,368	240,525
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Deferred revenue	3,134	2,880
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Total Current Liabilities	192,931	249,371
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Borrowings Under Revolving Credit Facility	40,000	—
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Deferred Income Taxes	69,704	69,693
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Other Long-term Liabilities	16,221	14,645
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Total Liabilities	318,856	333,709
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Commitments and Contingencies

Shareholders' Equity:

Common stock, \$.01 par value, 750,000 shares authorized; 157,405 and 159,031 shares issued and outstanding	1,574	1,590
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Capital in excess of par value	1,002,909	955,461
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Retained earnings	448,356	384,018
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Accumulated other comprehensive loss, net	(20,298)	(37,955)
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Total Shareholders' Equity	1,432,541	1,303,114
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Total Liabilities and Shareholders' Equity	\$1,751,397	\$1,636,823
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The accompanying notes are an integral part of these consolidated financial statements.

SEI Investments Company
Consolidated Statements of Operations

(unaudited)

(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenues:				
Asset management, administration and distribution fees	\$299,890	\$271,930	\$866,945	\$785,642
Information processing and software servicing fees	80,922	76,443	233,501	224,834
Transaction-based and trade execution fees	5,206	6,268	17,887	22,259
Total revenues	386,018	354,641	1,118,333	1,032,735
Expenses:				
Subadvisory, distribution and other asset management costs	45,578	42,586	131,368	122,651
Software royalties and other information processing costs	7,463	7,519	22,837	22,944
Brokerage commissions	3,978	4,864	13,163	17,065
Compensation, benefits and other personnel	118,421	103,137	336,919	307,350
Stock-based compensation	7,088	4,066	19,527	12,044
Consulting, outsourcing and professional fees	46,507	43,631	137,991	121,712
Data processing and computer related	18,449	16,581	53,104	48,081
Facilities, supplies and other costs	18,604	17,075	54,764	50,194
Amortization	13,745	11,388	38,332	33,684
Depreciation	6,948	6,576	20,347	19,457
Total expenses	286,781	257,423	828,352	755,182
Income from operations	99,237	97,218	289,981	277,553
Net gain from investments	645	196	1,036	320
Interest and dividend income	1,899	1,026	4,928	3,142
Interest expense	(345)	(115)	(571)	(416)
Equity in earnings of unconsolidated affiliate	39,333	32,565	109,213	92,042
Gain on sale of subsidiary	—	—	—	2,791
Income before income taxes	140,769	130,890	404,587	375,432
Income taxes	39,030	44,186	122,342	130,226
Net income	\$101,739	\$86,704	\$282,245	\$245,206
Basic earnings per common share	\$0.64	\$0.54	\$1.78	\$1.51
Shares used to compute basic earnings per share	157,902	160,916	158,439	161,908
Diluted earnings per common share	\$0.63	\$0.53	\$1.74	\$1.49
Shares used to compute diluted earnings per share	161,148	163,925	161,866	165,053
Dividends declared per common share	\$—	\$—	\$0.28	\$0.26

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

SEI Investments Company**Consolidated Statements of Comprehensive Income***(unaudited)**(In thousands)*

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income	\$ 101,739	\$ 86,704	\$ 282,245	\$ 245,206
Other comprehensive gain (loss), net of tax:				
Foreign currency translation adjustments	7,318	(3,053)	17,028	(5,704)
Unrealized gain (loss) on investments:				
Unrealized gains (losses) during the period, net of income taxes of \$(116), \$94, \$(148) and \$(146)	294	(160)	435	190
Less: reclassification adjustment for losses realized in net income, net of income taxes of \$(41), \$(52), \$(84) and \$(143)	105 399	102 (58)	194 629	266 456
Total other comprehensive gain (loss), net of tax	7,717	(3,111)	17,657	(5,248)
Comprehensive income	\$ 109,456	\$ 83,593	\$ 299,902	\$ 239,958

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

SEI Investments Company
Consolidated Condensed Statements of Cash Flows

(unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2017	2016
Cash flows from operating activities:		
Net income	\$282,245	\$245,206
Adjustments to reconcile net income to net cash provided by operating activities (See Note 1)	34,139	44,228
Net cash provided by operating activities	316,384	289,434
Cash flows from investing activities:		
Additions to property and equipment	(20,318)	(26,656)
Additions to capitalized software	(48,573)	(33,196)
Purchases of marketable securities	(50,235)	(55,162)
Prepayments and maturities of marketable securities	52,644	42,625
Sales of marketable securities	—	1,225
Cash paid for acquisition, net of cash acquired	(80,131)	—
Receipt of contingent payment from sale of SEI AK	—	2,791
Other investing activities	(1,450)	1,313
Net cash used in investing activities	(148,063)	(67,060)
Cash flows from financing activities:		
Borrowings under revolving credit facility	40,000	—
Purchase and retirement of common stock	(186,494)	(224,815)
Proceeds from issuance of common stock	41,626	35,159
Payment of dividends	(88,862)	(84,686)
Net cash used in financing activities	(193,730)	(274,342)
Effect of exchange rate changes on cash and cash equivalents	14,679	(4,531)
Net decrease in cash and cash equivalents	(10,730)	(56,499)
Cash and cash equivalents, beginning of period	695,701	679,661
Cash and cash equivalents, end of period	\$684,971	\$623,162

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

Notes to Consolidated Financial Statements

(all figures are in thousands except share and per share data)

Note 1. Summary of Significant Accounting Policies

Nature of Operations

SEI Investments Company (the Company), a Pennsylvania corporation, provides investment processing, investment management, and investment operations solutions to financial institutions, financial advisors, institutional investors, investment managers and ultra-high-net-worth families in the United States, Canada, the United Kingdom, continental Europe and various other locations throughout the world. Investment processing solutions consist of application and business process outsourcing services, professional services and transaction-based services. Revenues from investment processing solutions are recognized in Information processing and software servicing fees on the accompanying Consolidated Statements of Operations, except for fees earned associated with trade execution services which are recognized in Transaction-based and trade execution fees.

Investment management programs consist of mutual funds, alternative investments and separate accounts. These include a series of money market, equity, fixed-income and alternative investment portfolios, primarily in the form of registered investment companies. The Company serves as the administrator and investment advisor for many of these products. Revenues from investment management programs are recognized in Asset management, administration and distribution fees on the accompanying Consolidated Statements of Operations.

Investment operations solutions offer investment managers support for traditional investment products such as mutual funds, collective investment trusts, exchange-traded funds, and institutional and separate accounts, by providing outsourcing services including fund and investment accounting, administration, reconciliation, investor servicing and client reporting. These solutions also provide support to managers focused on alternative investments who manage hedge funds, funds of hedge funds, private equity funds and real estate funds, across registered, partnership and separate account structures domiciled in the United States and overseas. Revenues from investment operations solutions are recognized in Asset management, administration and distribution fees on the accompanying Consolidated Statements of Operations.

Basis of Presentation

The accompanying Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Certain financial information and accompanying note disclosure normally included in the Company's Annual Report on Form 10-K have been condensed or omitted. The interim financial information is unaudited but reflects all adjustments (consisting of only normal recurring adjustments) which are, in the opinion of management, necessary for a fair statement of financial position of the Company as of September 30, 2017, the results of operations for the three and nine months ended September 30, 2017 and 2016, and cash flows for the nine-month periods ended September 30, 2017 and 2016. These interim Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

There have been no significant changes in significant accounting policies during the nine months ended September 30, 2017 as compared to the significant accounting policies described in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 with the exception of the adoption of Accounting Standards Update (ASU) 2016-09, Improvements to Employee Share-Based Payment Accounting (ASU 2016-09) and the addition of the accounting policies related to business combinations and intangible assets. As required by ASU 2016-09, excess tax benefits recognized on stock-based compensation expense are reflected in the accompanying Consolidated Statements of Operations as a component of the provision for income taxes on a prospective basis (See Note 11). Additionally, excess tax benefits or deficiencies recognized on stock-based compensation expense are classified as an operating activity in the accompanying Consolidated Statements of Cash Flows. The Company has applied this provision retrospectively for the periods prior to the date of adoption. As a result, for the nine months ended September 30, 2016, net cash provided by operating activities increased by \$5,941 with a corresponding offset to net cash used for financing activities.

ASU 2016-09 also allows for the option to account for forfeitures as they occur when determining the amount of compensation cost to be recognized, rather than estimating expected forfeitures over the course of a vesting period. The Company elected to account for forfeitures as they occur. In addition, ASU 2016-09 eliminates anticipated windfalls and shortfalls that were included in the calculation of assumed proceeds for computing the dilutive effect of share-based payment awards in the calculation of diluted earnings per share. No adjustments to the Company's prior period reported diluted earnings per share amounts were permitted by ASU 2016-09.

The net cumulative effect to the Company from the adoption of ASU 2016-09 was an increase to paid-in capital of \$2,582, a reduction to retained earnings of \$1,669 and an increase to deferred tax assets of \$913 as of January 1, 2017.

Cash and Cash Equivalents

Cash and cash equivalents includes \$298,869 and \$374,760 at September 30, 2017 and December 31, 2016, respectively, primarily invested in SEI-sponsored open-ended money market mutual funds. The SEI-sponsored mutual funds are Level 1 assets.

Restricted Cash

Restricted cash includes \$3,000 at September 30, 2017 and December 31, 2016 segregated for regulatory purposes related to trade-execution services conducted by SEI Investments (Europe) Limited. Restricted cash also includes \$503 and \$500 at September 30, 2017 and December 31, 2016, respectively, segregated in special reserve accounts for the benefit of customers of the Company's broker-dealer subsidiary, SEI Investments Distribution Co. (SIDCO), in accordance with certain rules established by the Securities and Exchange Commission (SEC) for broker-dealers.

Capitalized Software

The Company capitalized \$48,573 and \$33,196 of software development costs during the nine months ended September 30, 2017 and 2016, respectively. The Company's software development costs primarily relate to the continued development of the SEI Wealth PlatformSM (the Platform). The Company capitalized \$40,604 and \$27,387 of software development costs for significant enhancements to the Platform during the nine months ended September 30, 2017 and 2016, respectively. As of September 30, 2017, the net book value of the Platform was \$283,639. The net book value includes \$27,344 of capitalized software development costs in-progress associated with future releases. The Platform has an estimated useful life of 15 years and a weighted average remaining life of 4.7 years. Amortization expense for the Platform was \$37,324 and \$33,387 during the nine months ended September 30, 2017 and 2016, respectively.

The amount of amortization expense recognized related to the SEI Wealth Platform is based upon management's estimate of its useful life. Management continually reassesses the estimated useful life of the Platform and any change in management's estimate could result in the remaining amortization expense to be accelerated or spread out over a longer period (See the caption "SEI Wealth Platform - Estimated Useful Life" of Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2 for more information).

The Company also capitalized \$7,969 and \$5,809 of software development costs during the nine months ended September 30, 2017 and 2016, respectively, related to an application for the Investment Managers segment. Capitalized software development costs in-progress at September 30, 2017 associated with the application were \$23,477. The application is not yet ready for use.

Business Combinations

The Company accounts for business combinations in accordance with Accounting Standards Codification Topic 805, Business Combinations (ASC 805). ASC 805 establishes principles and requirements for recognizing the total consideration transferred, assets acquired and liabilities assumed in a business combination. ASC 805 also provides guidance for recognizing and measuring goodwill acquired in a business combination and requires the acquirer to disclose information needed to evaluate and understand the financial impact of the business combination. The Company recognizes assets and liabilities acquired at their estimated fair values. Management uses judgment to identify the acquired assets and liabilities assumed; estimate the fair value of these assets and liabilities; estimate the useful life of the assets; and assess the appropriate method for recognizing depreciation or amortization expense over the estimated useful life of the assets.

Intangible Assets

The Company reviews long-lived assets and identifiable definite-lived intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. For purposes of recognizing and measuring an impairment loss, a long-lived asset is grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent.

Identifiable definite-lived intangible assets on the Company's Consolidated Balance Sheet are amortized on a straight-line basis according to their estimated useful lives (See Note 14). Goodwill recorded is not amortized but is reviewed for impairment annually or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The provisions of accounting guidance require that a two-step, fair value based test be performed to assess goodwill for impairment. In the first step,

the fair value of each reporting unit is compared with its carrying value, including goodwill. If the fair value exceeds the carrying value, goodwill is not impaired and no further testing is performed. The second step is performed if the carrying value exceeds the fair value. The second step requires an allocation of fair value to the individual assets and liabilities using a purchase price allocation in order to determine the implied fair value of goodwill. If the implied fair value of goodwill is less than the carrying amount, an impairment loss is recognized.

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Earnings per Share

The calculations of basic and diluted earnings per share for the three and nine months ended September 30, 2017 and 2016 are:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income	\$ 101,739	\$ 86,704	\$ 282,245	\$ 245,206
Shares used to compute basic earnings per common share	157,902,000	160,916,000	158,439,000	161,908,000
Dilutive effect of stock options	3,246,000	3,009,000	3,427,000	3,145,000
Shares used to compute diluted earnings per common share	161,148,000	163,925,000	161,866,000	165,053,000
Basic earnings per common share	\$0.64	\$ 0.54	\$ 1.78	\$ 1.51
Diluted earnings per common share	\$0.63	\$ 0.53	\$ 1.74	\$ 1.49

During the three months ended September 30, 2017 and 2016, employee stock options to purchase 11,324,000 and 10,258,000 shares of common stock with an average exercise price of \$37.81 and \$34.11, respectively, were outstanding but not included in the computation of diluted earnings per common share. During the nine months ended September 30, 2017 and 2016, employee stock options to purchase 11,286,000 and 10,384,000 shares of common stock with an average exercise price of \$37.73 and \$34.07, respectively, were outstanding but not included in the computation of diluted earnings per common share. These options for the three and nine month periods were not included in the computation of diluted earnings per common share because either the performance conditions have not been satisfied or would have been satisfied if the reporting date was the end of the contingency period or the option's exercise price was greater than the average market price of the Company's common stock and the effect on diluted earnings per common share would have been anti-dilutive.

Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation.

Statements of Cash Flows

For purposes of the Consolidated Statements of Cash Flows, the Company considers investment instruments purchased with an original maturity of three months or less to be cash equivalents.

The following table provides the details of the adjustments to reconcile net income to net cash provided by operating activities for the nine months ended September 30:

	2017	2016
Net income	\$282,245	\$245,206
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	20,347	19,457
Amortization	38,332	33,684
Equity in earnings of unconsolidated affiliate	(109,213)	(92,042)
Distributions received from unconsolidated affiliate	117,447	102,246
Stock-based compensation	19,527	12,044