

DIAMOND HILL INVESTMENT GROUP INC

Form 10-Q

November 06, 2009

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**United States Securities and Exchange Commission  
Washington, D.C. 20549  
Form 10-Q**

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

**For the quarterly period ended September 30, 2009**

**Commission file number 000-24498**

**DIAMOND HILL INVESTMENT GROUP, INC.**

(Exact name of registrant as specified in its charter)

Ohio

65-0190407

(State of incorporation)

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

325 John H. McConnell Blvd, Suite 200, Columbus, Ohio 43215

(Address, including Zip Code, of principal executive offices)

(614) 255-3333

(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, 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. See the 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  Smaller reporting company

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 issuer's common stock, as of November 6, 2009, is 2,617,574 shares.

DIAMOND HILL INVESTMENT GROUP, INC.

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**Table of Contents****PART I: FINANCIAL INFORMATION****ITEM 1: Consolidated Financial Statements****Diamond Hill Investment Group, Inc.****Consolidated Balance Sheets**

|   | 9/30/2009<br>(Unaudited) | 12/31/2008    |
|---|--------------------------|---------------|
| <b>ASSETS</b>   |                          |               |
| Cash and cash equivalents   | \$ 27,216,341            | \$ 15,788,560 |
| Investment portfolio  | 19,066,779               | 17,185,611    |
| Accounts receivable   | 7,732,948                | 5,339,558     |
| Prepaid expenses  | 702,817                  | 1,067,388     |
| Fixed assets, net of depreciation, and other assets                     | 1,222,508                | 835,314       |
| Income tax receivable   | 356,566                  | 2,334,836     |
| Deferred taxes  | 863,745                  | 1,989,016     |
| <br>  |                          |               |
| Total assets  | \$ 57,161,704            | \$ 44,540,283 |
| <br>  |                          |               |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                             |                          |               |
| Liabilities   |                          |               |
| Accounts payable and accrued expenses                                   | \$ 3,596,950             | \$ 1,294,396  |
| Accrued incentive compensation  | 8,460,000                | 13,000,000    |
| <br>  |                          |               |
| Total liabilities   | 12,056,950               | 14,294,396    |
| <br>  |                          |               |
| Commitments and contingencies   |                          |               |
| <br>  |                          |               |
| Shareholders' Equity  |                          |               |
| Common stock, no par value  |                          |               |
| 7,000,000 shares authorized;  |                          |               |
| 2,612,214 issued and outstanding at September 30, 2009;                 |                          |               |
| 2,447,299 issued and outstanding at December 31, 2008                   | 22,737,753               | 16,233,501    |
| Preferred stock, undesignated, 1,000,000 shares authorized and unissued |                          |               |
| Deferred compensation   | (4,425,245)              | (4,908,215)   |
| Retained earnings   | 26,792,246               | 18,920,601    |
| <br>  |                          |               |
| Total shareholders' equity  | 45,104,754               | 30,245,887    |
| <br>  |                          |               |
| Total liabilities and shareholders' equity                              | \$ 57,161,704            | \$ 44,540,283 |
| <br>  |                          |               |
| Tangible book value per share   | \$ 17.27                 | \$ 12.36      |

See notes to consolidated financial statements.

**Table of Contents****Diamond Hill Investment Group, Inc.  
Consolidated Statements of Income (unaudited)**

|                                     | Three Months Ended September<br>30, |               | Nine Months Ended September<br>30, |               |
|-------------------------------------|-------------------------------------|---------------|------------------------------------|---------------|
|                                     | 2009                                | 2008          | 2009                               | 2008          |
| <b>REVENUES:</b>                    |                                     |               |                                    |               |
| Investment advisory                 | \$ 9,516,666                        | \$ 11,577,006 | \$ 25,773,460                      | \$ 31,845,121 |
| Mutual fund administration, net     | 1,854,978                           | 1,770,894     | 4,075,351                          | 4,801,714     |
| <br>                                |                                     |               |                                    |               |
| Total revenue                       | 11,371,644                          | 13,347,900    | 29,848,811                         | 36,646,835    |
| <br>                                |                                     |               |                                    |               |
| <b>OPERATING EXPENSES:</b>          |                                     |               |                                    |               |
| Compensation and related costs      | 6,744,380                           | 7,125,709     | 17,267,784                         | 19,582,071    |
| General and administrative          | 809,375                             | 789,248       | 2,201,294                          | 1,946,986     |
| Sales and marketing                 | 157,539                             | 169,981       | 439,971                            | 440,911       |
| Third party distribution            | 201,259                             | 381,211       | 665,672                            | 1,173,037     |
| Mutual fund administration          | 610,522                             | 659,758       | 1,765,567                          | 1,700,639     |
| <br>                                |                                     |               |                                    |               |
| Total operating expenses            | 8,523,075                           | 9,125,907     | 22,340,288                         | 24,843,644    |
| <br>                                |                                     |               |                                    |               |
| <b>NET OPERATING INCOME</b>         | 2,848,569                           | 4,221,993     | 7,508,523                          | 11,803,191    |
| <br>                                |                                     |               |                                    |               |
| Investment return                   | 2,064,283                           | (2,319,263)   | 4,517,328                          | (4,025,376)   |
| <br>                                |                                     |               |                                    |               |
| <b>INCOME BEFORE TAXES</b>          | 4,912,852                           | 1,902,730     | 12,025,851                         | 7,777,815     |
| <br>                                |                                     |               |                                    |               |
| Income tax provision                | (1,708,934)                         | (678,339)     | (4,154,206)                        | (2,788,362)   |
| <br>                                |                                     |               |                                    |               |
| <b>NET INCOME</b>                   | \$ 3,203,918                        | \$ 1,224,391  | \$ 7,871,645                       | \$ 4,989,453  |
| <br>                                |                                     |               |                                    |               |
| Earnings per share                  |                                     |               |                                    |               |
| Basic                               | \$ 1.23                             | \$ 0.50       | \$ 3.06                            | \$ 2.09       |
| Diluted                             | \$ 1.23                             | \$ 0.50       | \$ 3.05                            | \$ 2.08       |
| <br>                                |                                     |               |                                    |               |
| Weighted average shares outstanding |                                     |               |                                    |               |
| Basic                               | 2,607,129                           | 2,430,772     | 2,572,006                          | 2,383,621     |
| Diluted                             | 2,611,933                           | 2,444,340     | 2,576,657                          | 2,396,999     |

See notes to consolidated financial statements.

**Table of Contents****Diamond Hill Investment Group, Inc.  
Consolidated Statements of Cash Flow (unaudited)**

|   | Nine Months Ended September 30, |               |
|---|---------------------------------|---------------|
|   | 2009                            | 2008          |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                                 |               |
| Net Income  | \$ 7,871,645                    | \$ 4,989,453  |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                                 |               |
| Depreciation on furniture and equipment   | 188,034                         | 131,610       |
| Amortization of deferred compensation   | 1,241,008                       | 2,287,358     |
| (Increase) in accounts receivable   | (2,393,390)                     | (1,932,008)   |
| Change in deferred taxes  | 1,112,086                       | (2,484,624)   |
| Stock option expense  |                                 | 2,233         |
| Noncash director fee expense  | 150,062                         | 167,281       |
| Investment (gain) loss, net   | (2,445,832)                     | 3,275,157     |
| Increase in accrued liabilities   | 2,614,770                       | 7,784,979     |
| Other changes in assets and liabilities   | 2,500,790                       | (390,528)     |
| Net cash provided by operating activities   | 10,839,173                      | 13,830,911    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                                 |               |
| Purchase of property and equipment  | (575,228)                       | (338,957)     |
| Cost of investments purchased and other portfolio activity                                  | (9,896,273)                     | (10,380,729)  |
| Proceeds from sale of investments   | 10,460,937                      | 13,704,181    |
| Net cash provided by (used in) investing activities   | (10,564)                        | 2,984,495     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                                 |               |
| Payment for repurchase of common shares   |                                 | (862,115)     |
| Payment of taxes withheld on employee stock transactions                                    | (26,865)                        | (167,335)     |
| Proceeds from common stock issuance   | 626,037                         | 1,301,554     |
| Net cash provided by financing activities   | 599,172                         | 272,104       |
| <b>CASH AND CASH EQUIVALENTS</b>  |                                 |               |
| Net change during the period  | 11,427,781                      | 17,087,510    |
| At beginning of period  | 15,788,560                      | 11,783,278    |
| At end of period  | \$ 27,216,341                   | \$ 28,870,788 |
| Cash paid during the period for:  |                                 |               |
| Interest  |                                 |               |
| Income taxes  | 1,655,900                       | 1,905,000     |



Noncash transactions during the period for:

Common stock issued as incentive compensation

4,852,216

5,754,140

See notes to consolidated financial statements.

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**Diamond Hill Investment Group, Inc.**

**Notes to Consolidated Financial Statements (unaudited)**

Note 1 Organization

Diamond Hill Investment Group, Inc. (the Company) was incorporated as a Florida corporation in April 1990 and in May 2002 reincorporated in Ohio, the Company's principal place of business. The Company has four operating subsidiaries.

Diamond Hill Capital Management, Inc. (DHCM), an Ohio corporation, is a wholly owned subsidiary of the Company and a registered investment advisor. DHCM is the investment adviser to the Diamond Hill Funds (the Funds), a series of open-end mutual funds, private investment funds (Private Funds), and also offers advisory services to institutional and individual investors.

Diamond Hill GP (Cayman) Ltd. (DHGP) was incorporated in the Cayman Islands as an exempted company on May 18, 2006 for the purpose of acting as the general partner of a Cayman Islands exempted limited partnership. This partnership acts as a master fund for Diamond Hill Offshore Ltd., a Cayman Islands exempted company; and Diamond Hill Investment Partners II, L.P., an Ohio limited partnership. Diamond Hill GP (Cayman) Ltd. has no operating activity.

Beacon Hill Fund Services, Inc. (BHFS), an Ohio corporation, is a wholly owned subsidiary of the Company incorporated on January 29, 2008. BHFS provides certain compliance, treasury, and fund administration services to mutual fund companies. BHIL Distributors, Inc. (BHIL), an Ohio corporation, is a wholly owned subsidiary of BHFS incorporated on February 19, 2008. BHIL provides underwriting and distribution services to mutual fund companies. BHFS and BHIL collectively operate as (Beacon Hill).

Note 2 Significant Accounting Policies

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses for the periods. Actual results could differ from those estimates. The following is a summary of the Company's significant accounting policies:

Principles of Consolidation

The accompanying consolidated financial statements include the operations of the Company and its subsidiaries. All material inter-company transactions and balances have been eliminated in consolidation.

Segment Information

Management has determined that the Company operates principally in one business segment, namely as an investment adviser to mutual funds, separate accounts, and private investment funds; and distributor, administrator, and transfer agent to mutual funds. Therefore, no disclosures relating to operating segments are required in annual or interim financial statements.

Cash and Cash Equivalents

Cash and cash equivalents include demand deposits and money market funds.

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Note 2 Significant Accounting Policies (Continued)

Accounts Receivable

Accounts receivable are recorded when they are due and are presented in the balance sheet, net of any allowance for doubtful accounts. Accounts receivable are written off when they are determined to be uncollectible. Any allowance for doubtful accounts is estimated based on the Company's historical losses, existing conditions in the industry, and the financial stability of those individuals or entities that owe the receivable. No allowance for doubtful accounts was deemed necessary at September 30, 2009 or December 31, 2008.

Valuation of Investment Portfolio

Investments held by the Company are valued based upon the definition of Level 1 inputs and Level 2 inputs. Level 1 inputs are defined as fair values which use quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are defined as quoted prices in markets that are not considered to be active for identical assets or liabilities, quoted prices in active markets for similar assets or liabilities and inputs other than quoted prices that are directly observable or indirectly through corroboration with observable market data. At September 30, 2009, \$3,877,128 and \$15,189,651 in Company investments are valued based upon Level 1 and Level 2 inputs, respectively.

The changes in market values on the investments are recorded in the Consolidated Statement of Income as investment returns.

Limited Partnership Interests

DHCM is the managing member of Diamond Hill General Partner, LLC, the General Partner of Diamond Hill Investment Partners, LP ( DHIP ), Diamond Hill Investment Partners II, LP ( DHIP II ), and Diamond Hill Research Partners, LP ( DHRP ), collectively (the Partnerships ), each a limited partnership whose underlying assets consist of marketable securities. DHCM in its role as the managing member of the General Partner exerts significant influence over the financial and operating policies of the Partnerships but does not exercise control. Therefore, DHCM's investment in the Partnerships is accounted for using the equity method, under which DHCM's share of the net earnings or losses from the partnership is reflected in income as earned, and distributions received are reflected as reductions from the investment. Several board members, officers and employees of the Company invest in DHIP and DHIP II through Diamond Hill General Partner, LLC. These individuals receive no remuneration as a result of their personal investment in the Partnerships. The capital of Diamond Hill General Partner, LLC is not subject to a management fee or an incentive fee.

Furniture and Equipment

Furniture and equipment, consisting of computer equipment, furniture, and fixtures, are carried at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over estimated lives of three to seven years.

Revenue Recognition - General

The Company earns substantially all of its revenue from investment advisory, distribution, and fund administration services. Mutual fund investment advisory and administration fees, generally calculated as a percentage of assets under management, are recorded as revenue as services are performed. Managed account and private investment fund clients provide for monthly or quarterly management fees, in addition to quarterly or annual performance fees.

**Table of Contents****Note 2 Significant Accounting Policies (Continued)****Revenue Recognition Performance Incentive Revenue**

The Company's private investment funds and certain managed accounts provide for performance incentive fees. For management fees based on a formula, there are two methods by which incentive revenue may be recorded. Under Method 1, incentive fees are recorded at the end of the contract period; under Method 2, the incentive fees are recorded periodically and calculated as the amount that would be due under the formula at any point in time as if the contract was terminated at that date. Management has chosen Method 1, in which incentive fees are recorded at the end of the contract period for the specific client in which the incentive fee applies. The table below shows assets under management (AUM) subject to performance incentive fees and the performance incentive fees as calculated under each of the above methods:

|   | As Of September 30,   |                       |
|---|-----------------------|-----------------------|
|   | 2009                  | 2008                  |
| AUM Contractual Period Ends Quarterly             | \$ 106,500,933        | \$ 249,888,929        |
| AUM Contractual Period Ends Annually              | 154,601,503           | 299,504,260           |
| <b>Total AUM Subject to Performance Incentive</b> | <b>\$ 261,102,436</b> | <b>\$ 549,393,189</b> |

|                                     | For The Three Months<br>Ending<br>September 30, |      | For The Nine Months Ending<br>September 30, |            |
|-------------------------------------|---|------|---|------------|
|                                     | 2009  | 2008 | 2009  | 2008       |
| Performance Incentive Fees Method 1 | \$  | \$   | \$ 4,645                                    | \$ 378,881 |
| Performance Incentive Fees Method 2 | \$ (20,620)                                     | \$   | \$ 179,406                                  | \$ 378,881 |

Amounts under Method 1 and Method 2 may differ throughout the year, but will generally be the same at fiscal year end because all client account contract periods end on December 31.

**Revenue Recognition Mutual Fund Administration**

DHCM has an administrative and transfer agency services agreement with the Diamond Hill Funds (the Funds), under which DHCM performs certain services for each fund. These services include mutual fund administration, transfer agency and other related functions. For performing these services, each fund compensates DHCM a fee at an annual rate of 0.34% for Class A and Class C shares and 0.20% for Class I shares times each series' average daily net assets. The Funds have selected and contractually engaged certain vendors to fulfill various services to benefit the Funds' shareholders or to satisfy regulatory requirements of the Funds. These services include, among others, required fund shareholder mailings, registration fees, legal and audit fees. DHCM, in fulfilling a portion of its role under the administration agreement with the Funds, acts as agent to pay these obligations of the Funds. Each vendor is independently responsible for fulfillment of the services it has been engaged to provide and negotiates fees and terms with the management and board of trustees of the Funds. The fee that the Funds pay to DHCM is reviewed annually by the Funds' board of trustees and specifically takes into account the contractual expenses that DHCM pays on behalf of the Funds. As a result, DHCM is not involved in the delivery or pricing of these services and bears no risk related to these services. Revenue has been recorded net of these Fund related expenses as it is the appropriate accounting treatment for this agency relationship. In addition, DHCM finances the up-front commissions which are paid by the Fund's principal underwriter to brokers who sell Class C shares of the Funds. As financier, DHCM advances to the underwriter the commission amount to be paid to the selling broker at the time of sale. These advances are capitalized and amortized over 12 months to correspond with the re-payments DHCM receives from the principal underwriter to recoup this commission advancement.



**Table of Contents**Note 2 **Significant Accounting Policies (Continued)****Revenue Recognition Mutual Fund Administration (Continued)**

Beacon Hill has underwriting and administrative service agreements with certain clients, including registered mutual funds. The fee arrangements vary from client to client based upon services provided and are recorded as revenue under Mutual Fund Administration. Part of Beacon Hill's role as underwriter is to act as an agent on behalf of its mutual fund clients to receive 12b-1/service fees and commission revenue and facilitate the payment of those fees and commissions to third parties who provide services to the funds and their shareholders. The amount of 12b-1/service fees and commissions are determined by each mutual fund client and Beacon Hill bears no financial risk related to these services. As a result, 12b-1/service fees and commission revenue has been recorded net of the expense payments to third parties as it is the appropriate accounting treatment for this agency relationship.

Mutual fund administration gross and net revenue are summarized below:

|  | Three Months Ended September |              | Nine Months Ended September |              |
|--|------------------------------|--------------|-----------------------------|--------------|
|  | 30,                          | 30,          | 30,                         | 30,          |
|  | 2009                         | 2008         | 2009                        | 2008         |
| Mutual fund administration:  |                              |              |                             |              |
| Administration Revenue, gross  | \$ 2,545,453                 | \$ 2,647,960 | \$ 6,535,520                | \$ 7,161,024 |
| 12b-1/service fees and commission revenue received from Fund clients | 1,770,999                    |              | 3,113,628                   |              |
| 12b-1/service fees and commission expense payments to third parties  | (1,770,999)                  |              | (3,113,628)                 |              |
| Fund related expense   | (709,395)                    | (892,451)    | (2,408,964)                 | (2,378,500)  |
| Revenue, net of fund related expenses                                | 1,836,058                    | 1,755,509    | 4,126,556                   | 4,782,524    |
| DHCM C-Share financing:  |                              |              |                             |              |
| Broker commission advance repayments                                 | 108,028                      | 502,519      | 631,497                     | 1,333,370    |
| Broker commission amortization                                       | (89,108)                     | (487,134)    | (682,702)                   | (1,314,180)  |
| Financing activity, net  | 18,920                       | 15,385       | (51,205)                    | 19,190       |
| Mutual fund administration revenue, net                              | \$ 1,854,978                 | \$ 1,770,894 | \$ 4,075,351                | \$ 4,801,714 |

**Third Party Distribution Expense**

Third party distribution expenses are earned by various third party financial services firms based on sales and/or assets of the Company's investment products generated by the respective firms. Expenses recognized represent actual payments made to the third party firms and are recorded in the period earned based on the terms of the various contracts.

**Income Taxes**

The Company accounts for income taxes through an asset and liability approach. A net deferred tax asset or liability is determined based on the tax effects of the various temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

The Company has analyzed its tax positions taken on federal income tax returns for all open tax years (tax years ended December 31, 2006 through 2008) to determine any uncertainty in income taxes and has recognized no adjustment in the net asset or liability.



**Table of Contents**Note 2 Significant Accounting Policies (Continued)Earnings Per Share

Basic earnings per share ( EPS ) excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution of EPS that could occur if options and warrants were exercised and restricted stock to issue common stock were vested.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period financial presentation.

Note 3 Investment Portfolio

As of September 30, 2009, the Company held investments worth \$19.1 million and a cost basis of \$16.7 million. The following table summarizes the market value of these investments as of September 30, 2009 and December 31, 2008:

|   | September 30,<br>2009 | December 31,<br>2008 |
|---|-----------------------|----------------------|
| Diamond Hill Small Cap Fund               | \$ 675,398            | \$                   |
| Diamond Hill Small-Mid Cap Fund           | 738,864               |                      |
| Diamond Hill Large Cap Fund               | 639,418               |                      |
| Diamond Hill Select Fund                  | 649,452               |                      |
| Diamond Hill Long-Short Fund              | 571,323               |                      |
| Diamond Hill Strategic Income Fund        | 602,673               |                      |
| Diamond Hill Investment Partners, L.P.    | 3,807,308             | 7,494,929            |
| Diamond Hill Investment Partners II, L.P. | 4,705,356             | 3,767,480            |
| Diamond Hill Research Partners, L.P.      | 6,676,987             |                      |
| Other marketable equity securities        |                       | 5,923,202            |
| <b>Total Investment Portfolio</b>         | <b>\$ 19,066,779</b>  | <b>\$ 17,185,611</b> |

DHCM is the managing member of the Diamond Hill General Partner LLC, which is the General Partner of the Partnerships. The underlying assets of the Partnerships are cash and marketable equity securities. The Company, as the parent entity to DHCM, is not contingently liable for the Partnership s liabilities but rather is only liable for its proportionate share, based on its membership interest. DHCM, as the managing member of the General Partner, is also not contingently liable for the Partnership s liabilities. Summary financial information, including the Company s carrying value and income from the Partnerships is as follows:

|                                     | September 30,<br>2009 | December 31,<br>2008 |
|-------------------------------------|-----------------------|----------------------|
| Total partnership assets            | \$ 187,781,843        | \$ 196,021,226       |
| Total partnership liabilities       | 41,112,728            | 33,056,747           |
| Net partnership assets              | 146,669,115           | 162,964,479          |
| Net partnership income (loss)       | 27,670,563            | (75,625,562)         |
| <br>                                |                       |                      |
| DHCM s portion of net assets        | 15,189,651            | 11,262,409           |
| DHCM s portion of net income (loss) | 4,002,243             | (3,866,314)          |

DHCM s income from the Partnerships includes its pro-rata capital allocation and its share of an incentive allocation, if any, from the limited partners.



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Note 4 Capital Stock

Common Shares

The Company has only one class of securities, Common Shares.

Authorization of Preferred Shares

The Company's Articles of Incorporation authorize the issuance of 1,000,000 shares of blank check preferred shares with such designations, rights and preferences, as may be determined from time to time by the Company's Board of Directors. The Board of Directors is authorized, without shareholder approval, to issue preferred stock with dividend, liquidation, conversion, voting, or other rights, which could adversely affect the voting or other rights of the holders of the Common Shares. There were no shares of preferred stock issued or outstanding at September 30, 2009 or December 31, 2008.

Note 5 Stock-Based Compensation

Equity Incentive Plans

*2005 Employee and Director Equity Incentive Plan*

At the Company's annual shareholder meeting on May 12, 2005, shareholders approved the 2005 Employee and Director Equity Incentive Plan ( 2005 Plan ). The 2005 Plan is intended to facilitate the Company's ability to attract and retain staff, provide additional incentive to employees, directors and consultants, and to promote the success of the Company's business. The 2005 Plan authorizes the issuance of Common Shares of the Company in various forms of stock or option grants. As of September 30, 2009, there were 356,449 shares available for issuance under the 2005 Plan. The 2005 Plan provides that the Board of Directors, or a committee appointed by the Board, may grant awards and otherwise administer the 2005 Plan. Restricted stock grants issued under the plan which vest over time, are recorded as deferred compensation on grant date and then recognized as compensation expense over the vesting period of the respective grant.

Equity Compensation Grants

On May 13, 2004, the Company's shareholders approved terms and conditions of certain equity compensation grants to three key employees. Under the approved terms, a total of 75,000 shares of restricted stock and restricted stock units were issued to the key employees on May 31, 2004. These shares vested on October 3, 2008.

*Accelerated Vesting of Certain Equity Incentive Plans and Compensation Grants*

The Board of Directors of the Company approved the accelerated vesting of 82,064 shares of restricted stock from various vesting dates during the first five months of 2009 to October 3, 2008. This acceleration resulted in additional compensation expense of \$1.0 million in the fourth quarter of 2008 that otherwise would have been recorded in the first and second quarters of 2009. In addition, as a result of this acceleration, the Company received a \$6.3 million tax deduction in 2008.

**Table of Contents****Note 5 Stock-Based Compensation (Continued)****401(k) Plan**

The Company sponsors a 401(k) plan under which all employees participate in the plan. Employees may contribute a portion of their compensation subject to certain limits based on federal tax laws. The Company makes matching contributions of Common Shares of the Company with a value equal to 200 percent of the first six percent of an employee's compensation contributed to the plan. Employees become fully vested in the matching contributions after six plan years of employment. For the three months ended September 30, 2009 and 2008, expenses attributable to the plan were \$188,039 and \$169,206, respectively. For the nine months ended September 30, 2009 and 2008, expenses attributable to the plan were \$558,598 and \$465,317.

**Stock Options and Warrants**

The Company recognizes all share-based payments to employees and directors, including grants of stock options, as expense in the income statement based on their fair values. The amount of compensation is measured at the fair value of the options when granted, and this cost is expensed over the required service period, which is normally the vesting period of the options. This expense recognition has been applied to options granted or modified after October 1, 2005. Compensation cost is recorded for prior option grants that vest after October 1, 2005.

Stock option and warrant transactions under the various plans are summarized below:

|                                | Options |                                       | Warrants |                                       |
|--------------------------------|---------|---------------------------------------|----------|---------------------------------------|
|                                | Shares  | Weighted<br>Average<br>Exercise Price | Shares   | Weighted<br>Average<br>Exercise Price |
| Outstanding December 31, 2007  | 92,500  | \$ 10.40                              | 25,400   | \$ 47.00                              |
| Exercisable December 31, 2007  | 72,500  | \$ 12.03                              | 25,400   | \$ 47.00                              |
| Granted                        |         |                                       |          |                                       |
| Expired / Forfeited            |         |                                       | 12,000   | 73.75                                 |
| Exercised                      | 85,500  | 8.95                                  | 3,000    | 56.67                                 |
| Outstanding September 30, 2008 | 7,000   | \$ 28.10                              | 10,400   | \$ 13.35                              |
| Exercisable September 30, 2008 | 7,000   | \$ 28.10                              | 10,400   | \$ 13.35                              |
| Outstanding December 31, 2008  |         | \$                                    | 10,000   | \$ 13.00                              |
| Exercisable December 31, 2008  |         | \$                                    | 10,000   | \$ 13.00                              |
| Granted                        |         |                                       |          |                                       |
| Expired / Forfeited            |         |                                       |          |                                       |
| Exercised                      |         |                                       | 4,000    | 16.88                                 |
| Outstanding September 30, 2009 |         | \$                                    | 6,000    | \$ 10.42                              |
| Exercisable September 30, 2009 |         | \$                                    | 6,000    | \$ 10.42                              |

**Table of Contents**Note 5 Stock-Based Compensation (Continued)Stock Options and Warrants (Continued)

Warrants outstanding and exercisable at September 30, 2009 are as follows:

| Number<br>Outstanding | Remaining<br>Life<br>In Years | Warrants              |                |
|-----------------------|-------------------------------|-----------------------|----------------|
|                       |                               | Number<br>Exercisable | Exercise Price |
| 4,000                 | 0.41                          | 4,000                 | \$ 11.25       |
| 2,000                 | 0.61                          | 2,000                 | 8.75           |
| 6,000                 | 0.48                          | 6,000                 |                |

The aggregate intrinsic value of warrants outstanding and exercisable as of September 30, 2009 is \$285,320.

Note 6 Operating Leases

The Company leases approximately 19,000 square feet of office space at its principal office under an operating lease agreement which terminates on July 31, 2016. In addition, the Company leases approximately 2,200 square feet of office space for a subsidiary company under an operating lease agreement which terminates on February 28, 2011. Total lease and operating expenses for the three months ended September 30, 2009 and 2008 were \$142,947 and \$100,389, respectively. Total lease and operating expenses for the nine months ended September 30, 2009 and 2008 were \$358,730 and \$290,103, respectively. The approximate future minimum lease payments under the operating leases are as follows:

| 2009      | 2010       | 2011       | 2012       | 2013       | Thereafter |
|-----------|------------|------------|------------|------------|------------|
| \$ 89,000 | \$ 358,000 | \$ 340,000 | \$ 348,000 | \$ 356,000 | \$ 929,000 |

In addition to the above rent, the Company will also be responsible for normal operating expenses of the properties. Such operating expenses were approximately \$8.90 per square foot in 2008 and are expected to be approximately \$9.79 per square foot in 2009 on a combined basis.

Note 7 Income Taxes

The provision for income taxes for the three months and nine months ended September 30, 2009 and 2008 consists of federal, state and city income taxes. As of December 31, 2008, the Company and its subsidiaries had a capital loss carry forward for tax purposes of approximately \$2,072,000. The capital loss carryforward is available to offset capital gains in future years.

Tax Impact of Stock Option and Warrant Exercises

For the nine months ended September 30, 2009, the Company received federal tax benefits of \$144,764 from the vesting of restricted stock grants, warrants exercised during 2009, and the disqualifying sale related to incentive stock options exercised during 2008, which resulted in an increase to equity during the period. For the year ended December 31, 2008, the Company received federal tax benefits from the exercise of stock-based compensation of \$3,805,977, which resulted in an increase to equity.

**Table of Contents****Note 8 Earnings Per Share**

The following table sets for the computation for basic and diluted earnings per share (EPS):

|   | Three Months Ended September |              | Nine Months Ended September |              |
|---|------------------------------|--------------|-----------------------------|--------------|
|   | 30,<br>2009                  | 2008         | 30,<br>2009                 | 2008         |
| Basic and Diluted net income                  | \$ 3,203,918                 | \$ 1,224,391 | \$ 7,871,645                | \$ 4,989,453 |
| Weighted average number of outstanding shares |                              |              |                             |              |
| Basic   | 2,607,129                    | 2,430,772    | 2,572,006                   | 2,383,621    |
| Diluted                                       | 2,611,933                    | 2,444,340    | 2,576,657                   | 2,396,999    |
| Earnings per share                            |                              |              |                             |              |
| Basic   | \$ 1.23                      | \$ 0.50      | \$ 3.06                     | \$ 2.09      |
| Diluted                                       | \$ 1.23                      | \$ 0.50      | \$ 3.05                     | \$ 2.08      |

**Note 9 Commitments and Contingencies**

The Company indemnifies its directors and certain of its officers and employees for certain liabilities that might arise from their performance of their duties to the Company. Additionally, in the normal course of business, the Company enters into agreements that contain a variety of representations and warranties and which provide general indemnifications. Certain agreements do not contain any limits on the Company's liability and would involve future claims that may be made against the Company that have not yet occurred. Therefore, it is not possible to estimate the Company's potential liability under these indemnities. Further, the Company maintains insurance policies that may provide coverage against certain claims under these indemnities.

**Note 10 Subsequent Events**

The Company evaluated subsequent events from September 30, 2009, the date of these financial statements, through November 6, 2009, the date these financial statements were issued and available. On November 4, 2009, the Company's board of directors approved a special cash dividend of \$10.00 per share payable December 15, 2009 to shareholders of record on December 1, 2009. This dividend will reduce shareholders equity by approximately \$26.2 million. There were no other subsequent events to report that would have a material impact on the Consolidated Financial Statements.

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DIAMOND HILL INVESTMENT GROUP, INC.

**ITEM 2: Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Forward-looking Statements**

Throughout this Form 10-Q, the Company may make forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 relating to such matters as anticipated operating results, prospects for achieving the critical threshold of assets under management, technological developments, economic trends (including interest rates and market volatility), expected transactions and acquisitions and similar matters. The words believe, expect, anticipate, estimate, should, hope, seek, plan, in, expressions identify forward-looking statements that speak only as of the date thereof. While the Company believes that the assumptions underlying its forward-looking statements are reasonable, investors are cautioned that any of the assumptions could prove to be inaccurate and accordingly, the actual results and experiences of the Company could differ materially from the anticipated results or other expectations expressed by the Company in its forward-looking statements. Factors that could cause such actual results or experiences to differ from results discussed in the forward-looking statements include, but are not limited to: the adverse effect from a decline in the securities markets; a decline in the performance of the Company's products; changes in interest rates; a general or prolonged downturn in the economy; changes in government policy and regulation, including monetary policy; changes in the Company's ability to attract or retain key employees; unforeseen costs and other effects related to legal proceedings or investigations of governmental and self-regulatory organizations; and other risks identified from time-to-time in the Company's public documents on file with the SEC.

**General**

Diamond Hill Investment Group, Inc. (the Company), an Ohio corporation organized in 1990, derives its consolidated revenue and net income from investment advisory and fund administration services provided by its subsidiaries Diamond Hill Capital Management, Inc. (DHCM), Beacon Hill Fund Services, Inc. (BHFS), and BHIL Distributors, Inc. (BHIL). BHFS and BHIL collectively operate as Beacon Hill. DHCM is a registered investment adviser under the Investment Advisers Act of 1940 providing investment advisory services to individuals and institutional investors through Diamond Hill Funds, separate accounts, and private investment funds (generally known as hedge funds). Beacon Hill was incorporated during the first quarter of 2008, and provides certain fund administration services and distribution services to mutual fund companies, including Diamond Hill Funds.

In this section, the Company discusses and analyzes the consolidated results of operations for the three and nine month periods ending September 30, 2009 and 2008 and other factors that may affect future financial performance. The accompanying unaudited consolidated financial statements were prepared in accordance with the instructions for Form 10-Q and, therefore, do not include information or footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with United States generally accepted accounting principles. Accordingly, these financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto of the Company included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. However, in the opinion of management, all adjustments (consisting of only normal recurring accruals) which are necessary for a fair presentation of the financial statements have been included. The results of operations for the three and nine month periods ended September 30, 2009, are not necessarily indicative of the results which may be expected for the entire fiscal year.

The Company's revenue is derived primarily from investment advisory and administration fees received from Diamond Hill Funds and investment advisory fees received from separate accounts and private investment funds. Investment advisory and administration fees paid to the Company are based primarily on the value of the investment portfolios managed by the Company and fluctuate with changes in the total value of the AUM. Such fees are recognized in the period that the Company manages these assets. The Company can also earn performance incentive fees which are generally 20% annually on the amount of client investment performance in excess of a certain annual return hurdle. Because performance incentive fees are based primarily on the performance of client accounts, they will be volatile from period to period. The Company's major expense is employee compensation and benefits.



**Table of Contents****Assets Under Management**

As of September 30, 2009, assets under management ( AUM ) totaled \$5.5 billion, a 1% decrease in comparison to September 30, 2008. Revenues are highly dependent on both the value and composition of AUM. The following is a summary of the Company's AUM by product and objective as of September 30, 2009 and 2008 and a roll-forward of AUM activity for the nine months ended September 30, 2009 and 2008:

| (in millions)            | <b>Assets Under Management by Product</b> |                 |                 |
|--------------------------|---|-----------------|-----------------|
|                          | <b>As of September 30,</b>                |                 |                 |
|                          | <b>2009</b>                               | <b>2008</b>     | <b>% Change</b> |
| Mutual funds             | \$ 3,317                                  | \$ 3,864        | -14%            |
| Separate accounts        | 1,957                                     | 1,315           | 49%             |
| Private investment funds | 215                                       | 369             | -42%            |
| <b>Total</b>             | <b>\$ 5,489</b>                           | <b>\$ 5,548</b> | <b>-1%</b>      |

| (in millions)              | <b>Assets Under Management by Objective</b> |                 |                 |
|----------------------------|---|-----------------|-----------------|
|                            | <b>As of September 30,</b>                  |                 |                 |
|                            | <b>2009</b>                                 | <b>2008</b>     | <b>% Change</b> |
| Small and Small-Mid Cap    | \$ 716                                      | \$ 582          | 23%             |
| Large Cap and Select       | 2,508                                       | 1,422           | 76%             |
| Long-Short                 | 2,115                                       | 3,363           | -37%            |
| Strategic and fixed income | 150   | 181             | -17%            |
| <b>Total</b>               | <b>\$ 5,489</b>                             | <b>\$ 5,548</b> | <b>-1%</b>      |

| (in millions)                                     | <b>Change in Assets Under Management</b> |                 |
|---|--|-----------------|
|   | <b>For the Nine Months Ended</b>         |                 |
|   | <b>September 30,</b>                     |                 |
|   | <b>2009</b>                              | <b>2008</b>     |
| AUM at beginning of the period                    | \$ 4,510                                 | \$ 4,403        |
| Net cash inflows (outflows)                       |  |                 |
| mutual funds                                      | (229)                                    | 1,482           |
| separate accounts                                 | 423                                      | 545             |
| private investment funds                          | (46)                                     | (73)            |
|   | 148                                      | 1,954           |
| Net market appreciation (depreciation) and income | 831                                      | (809)           |
| Increase during the period                        | 979                                      | 1,145           |
| <b>AUM at end of the period</b>                   | <b>\$ 5,489</b>                          | <b>\$ 5,548</b> |

**Table of Contents****Consolidated Results of Operations**

The following is a discussion of the consolidated results of operations of the Company and its revenues and expenses.

| (in thousands, except per share amounts)                | Three Months Ended September 30, |          |          | Nine Months Ended September 30, |          |          |
|---|----------------------------------|----------|----------|---------------------------------|----------|----------|
|   | 2009                             | 2008     | % Change | 2009                            | 2008     | % Change |
| Net operating income after tax <sup>(a)</sup>           | \$ 1,858                         | \$ 2,717 | -32%     | \$ 4,915                        | \$ 7,572 | -35%     |
| Net income  | \$ 3,204                         | \$ 1,224 | 162%     | \$ 7,872                        | \$ 4,989 | 58%      |
| Net operating income after tax per share <sup>(a)</sup> |                                  |          |          |                                 |          |          |
| Basic   | \$ 0.71                          | \$ 1.12  | -36%     | \$ 1.91                         | \$ 3.18  | -40%     |
| Diluted   | \$ 0.71                          | \$ 1.11  | -36%     | \$ 1.91                         | \$ 3.16  | -40%     |
| Net income per share                                    |                                  |          |          |                                 |          |          |
| Basic   | \$ 1.23                          | \$ 0.50  | 146%     | \$ 3.06                         | \$ 2.09  | 46%      |
| Diluted   | \$ 1.23                          | \$ 0.50  | 146%     | \$ 3.05                         | \$ 2.08  | 47%      |
| Weighted average shares outstanding                     |                                  |          |          |                                 |          |          |
| Basic   | 2,607                            | 2,431    |          | 2,572                           | 2,384    |          |
| Diluted   | 2,612                            | 2,444    |          | 2,577                           | 2,397    |          |

(a) Net operating income after tax is a non-GAAP performance measure. See Use of Supplemental Data as Non-GAAP Performance Measure on page 21 of this report.

**Three Months Ended September 30, 2009 compared with Three Months Ended September 30, 2008**

The Company generated net income of \$3,203,918 (\$1.23 per diluted share) for the three months ended September 30, 2009, compared with net income of \$1,224,391 (\$0.50 per diluted share) for the three months ended September 30, 2008. Net income increased 162% due primarily to a positive return on the Company's corporate investment portfolio of \$2.1 million for the three months ended September 30, 2009 compared to a negative return on the Company's corporate investment portfolio of \$2.3 million for the three months ended September 30, 2008. Excluding the corporate investment return, net operating income after tax decreased \$859 thousand, or 32%, for the period primarily due to a shift in composition of AUM from long-short strategies, which typically have a higher fee, to long-only strategies.

**Revenue**

| (in thousands) | Three Months Ended September 30, |      | % Change |
|----------------|----------------------------------|------|----------|
|                | 2009                             | 2008 |          |
|                |                                  |      |          |



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|                                 |    |        |    |        |      |
|---------------------------------|----|--------|----|--------|------|
| Investment advisory             | \$ | 9,517  | \$ | 11,577 | -18% |
| Mutual fund administration, net |    | 1,855  |    | 1,771  | 5%   |
| <br>                            |    |        |    |        |      |
| Total                           | \$ | 11,372 | \$ | 13,348 | -15% |

As a percent of total second quarter 2009 revenues, investment advisory fees accounted for 84% and mutual fund administration fees accounted for the remaining 16% compared to the second quarter of 2008 where investment advisory fees accounted for 87% and mutual fund administration fees accounted for the remaining 13% of revenues.

**Investment Advisory Fees.** The overall decrease in investment advisory fees was primarily due to a shift in AUM composition from long-short strategies to long only strategies, which resulted in a lower average advisory fee. Investment advisory fees are calculated as a percent of average net AUM at various levels depending on the investment product. The Company's average advisory fee rate for the three months ended September 30, 2009 was 0.74% compared to 0.82% for the three months ended September 30, 2008. Through September 30, 2009, the Long-Short Fund, which has a 0.90% advisory fee, experienced cash outflows resulting in a decrease in assets for that Fund of 34% from September 30, 2008. This factor contributed to the decrease in the average advisory fee rate for third quarter 2009 compared to third quarter 2008.

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**Mutual Fund Administration Fees.** Mutual fund administration fees are calculated as a percent of average net AUM in the Diamond Hill Funds. The Company earns 0.34% on Class A and Class C shares and 0.20% on Class I shares. Given the decrease in mutual fund AUM experienced during the second half of 2008 through the first quarter of 2009, effective April 30, 2009, the Company increased its administration fees. Fund administration revenues increased by \$84 thousand for the quarter ended September 30, 2009 compared to the quarter ended September 30, 2008 due to the change in fees during second quarter 2009.

**Expenses**

| (in thousands)                 | Three Months Ended |                 | % Change   |
|--------------------------------|--------------------|-----------------|------------|
|                                | September 30,      |                 |            |
|                                | 2009               | 2008            |            |
| Compensation and related costs | \$ 6,744           | \$ 7,126        | -5%        |
| General and administrative     | 809                | 789             | 3%         |
| Sales and marketing            | 158                | 170             | -7%        |
| Third party distribution       | 201                | 381             | -47%       |
| Mutual fund administration     | 611                | 660             | -7%        |
| <b>Total</b>                   | <b>\$ 8,523</b>    | <b>\$ 9,126</b> | <b>-7%</b> |

**Compensation and Related Costs.** Compensation expense decreased by \$382 thousand, or 5%, during the three months ended September 30, 2009 over the same period a year ago. This reflects a decrease of \$598 thousand in restricted stock expense due to an overall decrease in the total amount of long-term equity awards outstanding in 2009 compared to 2008 offset by an increase in base salaries and related benefits of \$216 thousand due to increased employee headcount. Incentive compensation for third quarter 2009 remained flat compared to third quarter 2008.

**General and Administrative.** General and administrative expenses increased by \$20 thousand, or 3%, period over period. This increase is primarily due to additional research expenses to support the Company's investment team and additional legal costs incurred during the quarter.

**Sales and Marketing.** Sales and marketing expenses decreased by \$12 thousand, or 7%. This decrease was primarily due to a decrease in travel and other marketing expenses.

**Third Party Distribution.** Third party distribution expense represents payments made to intermediaries related to sales of the Company's investment products. The expense is directly correlated with investments in the Company's private investment funds. The period over period increase or decrease directly corresponds to the increase or decrease in investment advisory fees earned by the Company.

**Mutual Fund Administration.** Mutual fund administration expense decreased by \$49 thousand, or 7%, period over period. The majority of mutual fund administration fees are variable based on the amount of mutual fund AUM. Despite an overall decrease in mutual fund AUM of \$547 thousand, or 14%, during the quarter ended September 30, 2009 compared to September 30, 2008, mutual fund administration expenses decreased only 7% due to a fee increase by the sub-administrator and timing differences of certain other administration expenses.

**Nine Months Ended September 30, 2009 compared with Nine Months Ended September 30, 2008**

The Company generated net income of \$7,871,645 (\$3.05 per diluted share) for the nine months ended September 30, 2009, compared with net income of \$4,989,453 (\$2.08 per diluted share) for the nine months ended September 30, 2008. Net income increased 58% despite a 1% decrease in AUM primarily due to a positive return on the Company's corporate investment portfolio of \$4.5 million for the nine months ended September 30, 2009, offset by a loss from Beacon Hill of \$822 thousand for the nine months ended September 30, 2009, compared to a negative return in the corporate investment portfolio of \$4.0 million for the nine months ended September 30, 2008 and a loss from Beacon Hill of \$1.0 million for the nine months ended September 30, 2008. Excluding the corporate investment return, net operating income after tax decreased \$2.7 million, or 35%, for the period primarily due to an average decline in AUM of 13% decline in the first half of 2009 and a shift in composition of AUM from long-short strategies, which typically

have a higher fee, to long-only strategies.

**Table of Contents****Revenue**

| (in thousands)                  | Nine Months Ended<br>September 30, |           | % Change |
|---------------------------------|------------------------------------|-----------|----------|
|                                 | 2009                               | 2008      |          |
| Investment advisory             | \$ 25,774                          | \$ 31,845 | -19%     |
| Mutual fund administration, net | 4,075                              | 4,802     | -15%     |
| Total                           | \$ 29,849                          | \$ 36,647 | -19%     |

As a percent of 2009 year to date revenues, investment advisory fees accounted for 86% and mutual fund administration fees accounted for the remaining 14% compared to the 2008 period where investment advisory fees accounted for 87% and mutual fund administration fees accounted for 13% of revenues.

**Investment Advisory Fees.** The overall decrease in investment advisory fees was primarily due to a shift in AUM composition from long-short strategies to long only strategies, which resulted in a lower average advisory fee. Investment advisory fees are calculated as a percent of average net AUM at various levels depending on the investment product. The Company's average advisory fee rate for the nine months ended September 30, 2009 was 0.74% compared to 0.82% for the nine months ended September 30, 2008. This decrease was mainly due to the decrease in AUM in the Diamond Hill Long-Short Fund, which has a 0.90% advisory fee. As of September 30, 2009, the Diamond Hill Long-Short Fund, which has a 0.90% advisory fee, experienced cash outflows resulting in a decrease in assets for that Fund of 34% from September 30, 2008. This factor contributed to the decrease in the average advisory fee rate for the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008.

**Mutual Fund Administration Fees.** Mutual fund administration fees are calculated as a percent of average net AUM in the Diamond Hill Funds. The Company earns 0.34% on Class A and Class C shares and 0.20% on Class I shares. Given the decrease in mutual fund AUM experienced during the second half of 2008 through the first quarter of 2009, effective April 30, 2009, the Company increased its fees. Due to a combination of fee changes and a reduction in mutual fund AUM of 14% as of September 30, 2009 compared to September 30, 2008, fund administration revenues decreased by \$6.1 million, or 19%, for the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008.

**Expenses**

| (in thousands)                 | Nine Months Ended<br>September 30, |           | % Change |
|--------------------------------|------------------------------------|-----------|----------|
|                                | 2009                               | 2008      |          |
| Compensation and related costs | \$ 17,268                          | \$ 19,582 | -12%     |
| General and administrative     | 2,201                              | 1,947     | 13%      |
| Sales and marketing            | 440                                | 441       | 0%       |
| Third party distribution       | 666                                | 1,173     | -43%     |
| Mutual fund administration     | 1,765                              | 1,701     | 4%       |
| Total                          | \$ 22,340                          | \$ 24,844 | -10%     |

**Compensation and Related Costs.** Employee compensation and benefits decreased by \$2.3 million, or 12%, during the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008, reflecting increases in employee headcount, base salaries and related benefits offset by a lower incentive compensation accrual. Base salaries and related benefits increased by \$925 thousand, or 15%, reflecting an increase in staffing from 56 to 63

employees offset by a decrease in restricted stock expense of \$1 million, or 46%, due to an overall decrease in the total amount of long-term equity awards outstanding in 2009 compared to 2008. Incentive compensation decreased by \$2.5 million, or 36%, reflecting a decrease in both revenue and operating income in the current fiscal year.

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**General and Administrative.** General and administrative expenses increased by \$254 thousand, or 13%. This increase is primarily due to additional research and technology expenses to support the Company's investment team and the rent expense due to the expansion of our office space in July 2009.

**Sales and Marketing.** Sales and marketing expenses remained flat period over period. Travel and other marketing efforts have remained relatively consistent in the first nine months of 2009 compared to the first nine months of 2008 related to new business growth.

**Third Party Distribution.** Third party distribution expense represents payments made to intermediaries related to sales of the Company's investment products. The period over period increase or decrease directly correspond to the increase or decrease in investment advisory fees earned by the Company.

**Mutual Fund Administration.** Mutual fund administration expense increased by \$64 thousand, or 4%. The majority of mutual fund administration fees are variable based on the amount of mutual fund AUM. Despite the decrease in mutual fund AUM by \$547 thousand, or 14%, during the nine months ended September 30, 2009 compared to nine months ended September 30, 2008, mutual fund administration expenses increased related to a fee increase by the sub-administrator and timing difference of certain other administration expenses.

**Beacon Hill Fund Services**

Beacon Hill is currently staffed with eleven experienced professionals, up from seven at September 30, 2008, and provides compliance, treasurer, and other regulatory oversight services to mutual fund clients. In addition, through its registered broker/dealer, Beacon Hill also serves as the underwriter for a number of mutual funds. Beacon Hill has been actively marketing its services and has commitments from several clients to commence services at various starting dates in 2009 and 2010. Most of these commitments are annually recurring engagements. The Company continues to believe that Beacon Hill will achieve a run rate breakeven by the end of 2009 and generate an operating profit in 2010. The following is a summary of Beacon Hill's performance for the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2008 excluding 12b-1/service fees and commission revenue and expenses, which net to zero:

|                         | Three Months Ended |              | Nine Months Ended |                |
|-------------------------|--------------------|--------------|-------------------|----------------|
|                         | September 30,      |              | September 30,     |                |
|                         | 2009               | 2008         | 2009              | 2008           |
| Gross revenue           | \$ 372,958         | \$ 28,250    | \$ 663,551        | \$ 47,637      |
| Less: revenue from DHCM | (42,725)           |              | (92,267)          |                |
| Net revenue             | 330,233            | 28,250       | 571,284           | 47,637         |
| Expenses                | 473,204            | 488,412      | 1,393,693         | 1,074,504      |
| Net loss                | \$ (142,971)       | \$ (460,162) | \$ (822,409)      | \$ (1,026,867) |

**Liquidity and Capital Resources**

The Company's entire investment portfolio is in liquid securities, which provide for cash liquidity, if needed, within three business days. Investments in mutual funds are valued at their current net asset value. Investments in private investment funds and other equity securities are valued based on readily available market quotations. Inflation is expected to have no material impact on the Company's performance.

As of September 30, 2009, the Company had working capital of approximately \$41.9 million compared to \$24.1 million at December 31, 2008. Working capital includes cash, securities owned and accounts receivable, net of all liabilities. The Company has no debt and its available working capital is expected to be sufficient to cover current expenses. The Company does not expect any material capital expenditures during 2009.



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During the third quarter of 2007 the Board of Directors authorized management to repurchase up to 350,000 shares of the Company's common stock. Management and the board believe that the most appropriate use for excess cash is to invest in Diamond Hill investment strategies or repurchase the Company's common stock. The deciding factor will be which alternative offers the most favorable risk-adjusted rate of return in the opinion of management and the board.

**Use of Supplemental Data as Non-GAAP Performance Measure****Net Operating Income After Tax**

As supplemental information, we are providing performance measures that are based on methodologies other than generally accepted accounting principles ( non-GAAP ) for Net Operating Income After Tax that management uses as benchmarks in evaluating and comparing the period-to-period operating performance of the Company and its subsidiaries.

The Company defines net operating income after tax as the Company's net operating income less income tax provision excluding investment return and the tax impact related to the investment return. The Company believes that net operating income after tax provides a good representation of the Company's operating performance as it excludes the impact of investment return on financial results. The amount of the investment portfolio and market fluctuations on the investments can fluctuate significantly from one period to another, as seen over the past year, which can distort the underlying earnings potential of a company. We also believe net operating income after tax is an important metric in estimating the value of an asset management business. This measure is provided in addition to net income and net operating income and is not a substitute for net income or net operating income and may not be comparable to non-GAAP performance measures of other companies.

|  | Three Months Ended Sept. 30, |              | Nine Months Ended Sept. 30, |               |
|--|------------------------------|--------------|-----------------------------|---------------|
|  | 2009                         | 2008         | 2009                        | 2008          |
| Net Operating Income, GAAP basis                                 | \$ 2,848,569                 | \$ 4,221,993 | \$ 7,508,523                | \$ 11,803,191 |
| Non-GAAP Adjustments:  |                              |              |                             |               |
| Tax Provision excluding impact of Investment Return              | 990,874                      | 1,505,175    | 2,593,742                   | 4,231,467     |
| Net operating income after tax, non-GAAP basis                   | 1,857,695                    | 2,716,818    | 4,914,781                   | 7,571,724     |
| Net operating income after tax per basic share, non-GAAP basis   | \$ 0.71                      | \$ 1.12      | \$ 1.91                     | \$ 3.18       |
| Net operating income after tax per diluted share, non-GAAP basis | \$ 0.71                      | \$ 1.11      | \$ 1.91                     | \$ 3.16       |
| Basic weighted average shares outstanding, GAAP basis            | 2,607,129                    | 2,430,772    | 2,572,006                   | 2,383,621     |
| Diluted weighted average shares outstanding, GAAP basis          | 2,611,933                    | 2,444,340    | 2,576,657                   | 2,396,999     |

**Off-Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements with any obligation under a guarantee contract, or a retained or contingent interest in assets or similar arrangement that serves as credit, liquidity or market risk support for such assets, or any other obligation, including a contingent obligation, under a contract that would be accounted for as a derivative instrument or arising out of a variable interest.

**Critical Accounting Policies and Estimates**

There have been no material changes to the Critical Accounting Policies and Estimates provided in Item 7 of the Company's Annual Report on Form 10-K for the year ended December 31, 2008.





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DIAMOND HILL INVESTMENT GROUP, INC.

**ITEM 3: Quantitative and Qualitative Disclosures About Market Risk**

There has been no material change in the information provided in Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

**ITEM 4: Controls and Procedures**

Management, including the Chief Executive Officer and the Chief Financial Officer, has conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934) as of the end of the period covered by this quarterly report (the Evaluation Date). Based on such evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that as of the Evaluation Date, the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and to ensure that the information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. There have not been any changes in the Company's internal control over financial reporting that have materially affected or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II: OTHER INFORMATION**

**ITEM 1: Legal Proceedings**

From time to time, the Company is party to various legal proceedings that are incidental to its business. The Company believes that none of these matters, either individually or in the aggregate, is reasonably likely to have a material adverse effect on its consolidated financial condition, liquidity or results of operations.

**ITEM 1A: Risk Factors**

There has been no material change to the information provided in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

**ITEM 2: Unregistered Sales of Equity Securities and Use of Proceeds**

The Company did not purchase any shares of its common stock during the three months ended September 30, 2009. There remain 333,895 shares available to be purchased under a repurchase program approved by the Board of Directors and announced on August 9, 2007. This stock repurchase program is not subject to an expiration date.

**ITEM 3: Defaults Upon Senior Securities**

None

**ITEM 4: Submission of Matters to a Vote of Security Holders**

None

**ITEM 5: Other Information**

None

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DIAMOND HILL INVESTMENT GROUP, INC.

**ITEM 6: Exhibits**

- 3.1 Amended and Restated Articles of Incorporation of the Company. (Incorporated by reference from Form 8-K Current Report for the event on May 2, 2002 filed with the SEC on May 7, 2002; File No. 000-24498.)
- 3.2 Code of Regulations of the Company. (Incorporated by reference from Form 8-K Current Report for the event on May 2, 2002 filed with the SEC on May 7, 2002; File No. 000-24498.)
- 31.1 Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a).
- 31.2 Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a).
- 32.1 Section 1350 Certifications.

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DIAMOND HILL INVESTMENT GROUP, INC.

**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.

DIAMOND HILL INVESTMENT GROUP, INC.

| Date             | Title   | Signature                            |
|------------------|---|--------------------------------------|
| November 6, 2009 | President, Chief Executive Officer,<br>and a Director | /s/ R. H. Dillon<br>R. H. Dillon     |
| November 6, 2009 | Chief Financial Officer, Treasurer,<br>and Secretary  | /s/ James F. Laird<br>James F. Laird |

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