Pzena Investment Management, Inc.
Form 10-Q
August 13, 2008

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2008

OR

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

For the transition period from: to
Commission File Number 001-33761

PZENA INVESTMENT MANAGEMENT, INC.

(Exact name of registrant as specified in its charter)

Delaware	**20-8999751**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

120 West 45th Street New York, New York	**10036**
(Address of principal executive offices)	(Zip Code)

(212) 355-1600
(Registrant's telephone number including area code)

Not Applicable
(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 ý No o

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. (Check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer ý (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of August 13, 2008 there were 6,123,494 outstanding shares of the registrant's Class A common stock, par value $0.01 per share.

As of August 13, 2008 there were 57,950,910 outstanding shares of the registrant's Class B common stock, par value $0.000001 per share.

PZENA INVESTMENT MANAGEMENT, INC.
FORM 10-Q
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EXPLANATORY NOTE

On October 30, 2007, Pzena Investment Management, Inc. (the "Company") consummated an initial public offering of 6,100,000 shares of its Class A common stock in which it received net proceeds of approximately $98.9 million that it used to purchase 6,100,000 membership units of Pzena Investment Management, LLC, representing 9.5% of the then outstanding membership units of Pzena Investment Management, LLC. Concurrently with the consummation of this initial public offering, (i) the operating agreement of Pzena Investment Management, LLC (the "Operating Agreement") was amended and restated such that, among other things, the Company became the sole managing member of Pzena Investment Management, LLC and (ii) related reorganization transactions were consummated. Accordingly, as of and subsequent to October 30, 2007, (i) the Company will consolidate the financial results of Pzena Investment Management, LLC with its own and reflect the remaining membership interest in Pzena Investment Management, LLC as a non-controlling interest in its consolidated financial statements, and (ii) the Company's income will be generated by its economic interest in Pzena Investment Management, LLC's net income. As of June 30, 2008, the holders of Class A common stock (through the Company) and the holders of Class B units of the operating company held approximately 9.6% and 90.4%, respectively, of the economic interests in the operations of the business. Therefore, this Quarterly Report on Form 10-Q presents the following financial statements:

1) the consolidated statements of operations and the consolidated statements of cash flows of the Company for the three and six months ended June 30, 2008; the consolidated statement of changes in equity of the Company for the six months ended June 30, 2008; and the consolidated statements of financial condition of the Company as of June 30, 2008 and December 31, 2007; and

2) the consolidated statements of operations and the consolidated statements of cash flows of Pzena Investment Management, LLC for the three and six months ended June 30, 2007; and the consolidated statement of changes in equity of Pzena Investment Management LLC for the six months ended June 30, 2007.

"We," "us," "our," and the "Company" refer to: (i) Pzena Investment Management, Inc. and its subsidiaries, including Pzena Investment Management, LLC and all of its subsidiaries, following the consummation of the above-referenced initial public offering, amendment and restatement of the Operating Agreement and related reorganization transactions on October 30, 2007, and (ii) to Pzena Investment Management, LLC and all of its subsidiaries prior to the consummation of these transactions. The "operating company" refers to Pzena Investment Management, LLC.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements. Forward-looking statements provide our current expectations, or forecasts, of future events. Forward-looking statements include statements about our expectations, beliefs, plans, objectives, intentions, assumptions and other statements that are not historical facts. Words or phrases such as "anticipate," "believe," "continue," "ongoing," "estimate," "expect," "intend," "may," "plan," "potential," "predict," "project" or similar words or phrases, or the negatives of those words or phrases, may identify forward-looking statements, but the absence of these words does not necessarily mean that a statement is not forward-looking.

Forward-looking statements are subject to known and unknown risks and uncertainties and are based on potentially inaccurate assumptions that could cause actual results to differ materially from those expected or implied by the forward-looking statements. Our actual results could differ materially from those anticipated in forward-looking statements for many reasons, including the factors described in Item 1A, "Risk Factors" in Part I of our Annual Report on Form 10-K for our fiscal year ended December 31, 2007. Accordingly, you should not unduly rely on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to

publicly revise any forward-looking statements to reflect circumstances or events after the date of this Quarterly Report on Form 10-Q, or to reflect the occurrence of unanticipated events. You should, however, review the factors and risks we describe in the reports we will file from time to time with the SEC after the date of this Quarterly Report on Form 10-Q.

Forward-looking statements include, but are not limited to, statements about:

- our anticipated future results of operations and operating cash flows;
- our business strategies and investment policies;
- our financing plans and the availability of short-term and long-term borrowing;
- our competitive position and the effects of competition on our business;
- potential growth opportunities available to us;
- the recruitment and retention of our employees;
- our expected levels of compensation for our employees;
- our potential operating performance, achievements, efficiency and cost reduction efforts;
- our expected tax rate;
- changes in interest rates;
- our expectations with respect to the economy, capital markets, the market for asset management services and other industry trends;
- the benefits to our business resulting from the effects of the reorganization we consummated on October 30, 2007; and
- the impact of future legislation and regulation, and changes in existing legislation and regulation, on our business.

The reports that we file with the SEC, accessible on the SEC's website at *www.sec.gov*, identify additional factors that can affect forward-looking statements.

PZENA INVESTMENT MANAGEMENT, INC.

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(in thousands, except share and per-share amounts)

	As of	
	June 30, 2008 (unaudited)	December 31, 2007
ASSETS		
Cash and Cash Equivalents	$ 37,207	$ 27,184
Due from Broker	89	268
Advisory Fees Receivable	20,497	26,061
Investments in Marketable Securities, at Fair Value	33,152	27,465
Receivable from Related Parties	319	351
Other Receivables	323	1,040
Prepaid Expenses and Other Assets	1,315	881
Deferred Tax Asset	67,063	68,233
Property and Equipment, Net of Accumulated Depreciation of $1,645 and $1,412, respectively	3,012	3,163
TOTAL ASSETS	$ 162,977	$ 154,646
LIABILITIES AND EQUITY		
Liabilities:		
Accounts Payable and Accrued Expenses	$ 11,813	$ 8,542
Securities Sold Short, at Fair Value	3,309	1,028
Due to Broker	3,456	4,101
Dividends Payable	7,058	7,045
Long Term Debt	57,000	60,000
Liability to Selling Shareholders	58,391	58,391
Other Liabilities	1,349	1,105
TOTAL LIABILITIES	142,376	140,212
Commitments and Contingencies		
Non-Controlling Interests	18,524	16,355
Equity:		
Preferred Stock (Par Value $0.01; 200,000,000 Shares Authorized; None Outstanding)		
Class A Common Stock (Par Value $0.01; 750,000,000 Shares Authorized; 6,123,494 and 6,111,118 Shares Issued and Outstanding in 2008 and 2007, respectively)	61	61
Class B Common Stock (Par Value $0.000001; 750,000,000 Shares Authorized; 57,950,910 and 57,937,910 Shares Issued and Outstanding in 2008 and 2007, respectively)		
Additional Paid-In Capital	1,635	(2,043)
Accumulated Other Comprehensive Income	67	
Retained Earnings	314	61
TOTAL EQUITY	2,077	(1,921)
TOTAL LIABILITIES AND EQUITY	$ 162,977	$ 154,646

See accompanying notes to consolidated financial statements

PZENA INVESTMENT MANAGEMENT, INC.

(Prior to October 30, 2007 Pzena Investment Management, LLC)

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per-share amounts)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2008	2007	2008	2007
REVENUE	$ 28,305	$ 36,840	$ 58,317	$ 72,138
EXPENSES				
Compensation and Benefits Expense	8,662	8,582	17,613	112,406
General and Administrative Expenses	2,652	2,540	5,695	4,629
TOTAL OPERATING EXPENSES	11,314	11,122	23,308	117,035
Operating Income/(Loss)	16,991	25,718	35,009	(44,897)
OTHER INCOME/(EXPENSE)				
Interest Income	211	279	426	565
Interest Expense	(1,056)		(2,037)	
Dividend Income, Net	330	142	611	271
Realized and Unrealized Gain/(Loss), Net on Marketable Securities and Securities Sold Short	(3,300)	1,125	(6,880)	955
Equity in Earnings of Affiliates		187		145
Other	26	(7)	12	25
Total Other Income/(Expense)	(3,789)	1,726	(7,868)	1,961
Income/(Loss) Before Income Taxes and Non-Controlling Interests	13,202	27,444	27,141	(42,936)
Provision for Income Taxes	1,456	1,478	2,998	2,607
Non-Controlling Interests	10,966	646	22,543	637
Income/(Loss) Before Interest on Mandatorily Redeemable Units	780	25,320	1,600	(46,180)
Interest on Mandatorily Redeemable Units				16,575
Net Income/(Loss)	$ 780	$ 25,320	$ 1,600	$ (62,755)
Net Income for Basic Earnings per Share	$ 780		$ 1,600	
Basic Earnings per Share	$ 0.13		$ 0.26	
Basic Weighted Average Shares Outstanding	6,123,494		6,121,590	
Net Income for Diluted Earnings per Share	$ 8,124		$ 16,722	
Diluted Earnings per Share	$ 0.13		$ 0.26	
Diluted Weighted Average Shares Outstanding	64,080,857		64,079,122	

See accompanying notes to consolidated financial statements

PZENA INVESTMENT MANAGEMENT, INC.
(Prior to October 30, 2007 Pzena Investment Management, LLC)

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2008	2007	2008	2007
OPERATING ACTIVITIES				
Net Income/(Loss)	$ 780	$ 25,320	$ 1,600	$ (62,755)
Adjustments to Reconcile Net Income/(Loss) to Cash				
Provided by Operating Activities:				
Depreciation	118	84	233	158
Non-Cash Compensation	389	49	633	82,887
Non-Cash Interest on Mandatorily Redeemable Units				(2,420)
Director Share Grant			140	
Realized and Unrealized Loss/(Gain), Net on Marketable Securities and Securities Sold Short	3,300	(1,125)	6,880	(955)
Non-Controlling Interests	10,966	646	22,543	637
Equity in Earnings of Affiliates		(187)		(145)
Deferred Income Taxes	517	237	1,064	6
Changes in Operating Assets and Liabilities:				
Advisory Fees Receivable	1,128	852	5,564	(837)
Due from Broker	(12)	(27)	179	738
Restricted Cash		(15)		(37)
Prepaid Expenses and Other Assets	46	(1,645)	1,157	(1,152)
Due to Broker	3,330	(7)	(645)	(2,698)
Accrued Expenses, Accounts Payable and Other Liabilities	1,776	4,182	3,284	8,250
Purchases of Marketable Securities and Securities Sold Short	(5,309)	(2,519)	(22,145)	(9,505)
Proceeds from Sale of Marketable Securities and Securities Sold Short	5,190	1,990	11,857	9,443
Net Cash Provided by Operating Activities	**22,219**	**27,835**	**32,344**	**21,615**
INVESTING ACTIVITIES				
Receivable from Related Parties	(1)		31	76
Purchases of Property and Equipment	(33)	(1,422)	(82)	(1,454)
Net Cash Provided by/(Used in) Investing Activities	**(34)**	**(1,422)**	**(51)**	**(1,378)**
FINANCING ACTIVITIES				
Contributions from Members for Option Exercise		3,609		3,609
Contributions from Non-Controlling Interests	100	759	6,933	2,221
Distributions to Non-Controlling Interests	(15)		(1,095)	(2,067)
Debt Repayment	(3,000)		(3,000)	
Dividends	(672)		(1,344)	
Distributions to Members	(17,391)	(44,909)	(23,764)	(44,909)
Net Cash Used in Financing Activities	**(20,978)**	**(40,541)**	**(22,270)**	**(41,146)**
NET CHANGE IN CASH	**$ 1,207**	**$ (14,128)**	**$ 10,023**	**$ (20,909)**

CASH AND CASH EQUIVALENTS Beginning of Period	$	36,000	$	24,139	$	27,184	$	30,920
Net Change in Cash		1,207		(14,128)		10,023		(20,909)
CASH AND CASH EQUIVALENTS End of Period	$	37,207	$	10,011	$	37,207	$	10,011
Supplementary Cash Flow Information:								
Interest Paid:								
On Mandatorily Redeemable Units	$		$		$		$	18,995
Other	$	1,032	$		$	2,014	$	
Income Taxes Paid	$	1,650	$	2,650	$	3,042	$	2,650

See accompanying notes to consolidated financial statements

PZENA INVESTMENT MANAGEMENT, INC.
(Prior to October 30, 2007 Pzena Investment Management, LLC)
UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(in thousands, except share and per-share amounts)

	Capital Units	Shares of Class A Common Stock	Shares of Class B Common Stock	Members' Capital	Class A Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Excess of Liabilities Over Assets	Total
Balance at December 31, 2007		**6,111,118**	**57,937,910**	**$**	**$ 61**	**$ (2,043)**	**$ 61**	**$**	**$**	**$ (1,921)**
Issuance of Class A Common Stock		12,376				11				**11**
Issuance of Class B Common Stock			13,000							
Net Income							1,600			**1,600**
Capital Contribution						172				**172**
Amortization of Deferred Compensation						28				**28**
Accumulated Other Comprehensive Income								67		**67**
Equity Effect of Operating Company Net Deficit on Non-Controlling Interests						3,467				**3,467**
Class A Cash Dividends Declared ($0.11 per share)							(1,347)			**(1,347)**
Balance at June 30, 2008		**6,123,494**	**57,950,910**	**$**	**$ 61**	**$ 1,635**	**$ 314**	**$ 67**	**$**	**$ 2,077**
Balance at December 31, 2006				**$**	**$**	**$**	**$**	**$**	**$ (729,966)**	**$ (729,966)**
Net Loss Before Interest on Mandatorily Redeemable Units							25,320		(71,500)	**(46,180)**
Interest on Mandatorily Redeemable Units									(16,575)	**(16,575)**
Amortization of Deferred Compensation				49					1,901	**1,950**
Reclassification of Liabilities to Capital Units	63,778,720			875,096			(816,140)		816,140	**875,096**
Unit Forfeiture	(7,500)									
Option Excerise	266,690			3,609						**3,609**
Distribution to Members				(44,909)						**(44,909)**
Balance at June 30, 2007	**64,037,910**			**$ 833,845**	**$**	**$**	**$ (790,820)**	**$**	**$**	**$ 43,025**

See accompanying notes to consolidated financial statements

PZENA INVESTMENT MANAGEMENT, INC.
(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements

Note 1 Organization

The Company functions as the holding company through which the business of its operating company, Pzena Investment Management, LLC, is conducted. The Company was incorporated in the State of Delaware on May 8, 2007. On May 10, 2007, the Company issued 100 shares of its common stock for $100 to Richard S. Pzena, the sole director of the Company as of that date. On October 30, 2007, the Company consummated an initial public offering of 6,100,000 shares of its Class A common stock, par value $0.01 per share, for net proceeds of approximately $98.9 million, after payment of underwriting discounts and offering expenses. These net proceeds were used to purchase 6,100,000 membership units of Pzena Investment Management, LLC, representing 9.5% of its then outstanding membership units, from its two outside investors and one former employee. Concurrently with the consummation of the Company's initial public offering, the Operating Agreement of Pzena Investment Management, LLC (the "Operating Agreement") was amended and restated such that, among other things, the Company became the sole managing member of Pzena Investment Management, LLC. The acquisition of the operating company's membership interests by the Company has been treated as a reorganization of entities under common control pursuant to the guidance set forth in Financial Accounting Standards Board Technical Bulletin No. 85-5, *Issues Relating to Accounting for Business Combinations* ("FTB 85-5"). Accordingly, the net assets assumed by the Company through the offering have been reported at Pzena Investment Management, LLC's historical cost basis. As a result of these transactions, as of and subsequent to October 30, 2007, (i) the Company has consolidated the financial results of Pzena Investment Management, LLC with its own and reflected the membership interest in it that it does not own as a non-controlling interest in its consolidated financial statements, and (ii) the Company's income will be generated by its economic interest in Pzena Investment Management, LLC's net income. Reported results for the periods prior to October 30, 2007 reflect solely the operations of Pzena Investment Management, LLC.

Pzena Investment Management, LLC is an investment adviser which is registered under the Investment Advisers Act of 1940 and is headquartered in New York, New York. As of June 30, 2008, the Company managed assets in a variety of value-oriented investment strategies across a wide range of market capitalizations in both U.S. and international capital markets.

The Company, through its investment in its operating company, has consolidated the results of operations and financial condition of the following private investment partnerships as of June 30, 2008:

Entity	Type of Entity (Date of Formation)	Ownership at June 30, 2008
Pzena Large Cap Value Fund	Massachusetts Trust (11/01/2002)	99.6%
Pzena Large Cap Value Fund II	Massachusetts Trust (08/01/2006)	99.9%
Pzena International Value Service	Delaware Limited Liability Company (12/22/2003)	2.2%
Pzena Global Value Service	Delaware Limited Liability Company (12/22/2003)	0.0%
Pzena Mega Cap Value Fund	Massachusetts Trust (02/23/2007)	99.9%
Pzena Value Partners	Limited Partnership (01/22/2008)	16.8%
Pzena Emerging Market Countries Value Service	Delaware Limited Liability Company (12/28/2007)	99.9%
Pzena Emerging Markets Focused Value Service	Delaware Limited Liability Company (12/28/2007)	99.9%

Pursuant to its Operating Agreement, the operating company will continue until December 31, 2026, unless a terminating event, as defined in the Operating Agreement, occurs prior to this date. Operating company members are not liable for repayment, satisfaction or discharge of any debts, liabilities or obligations of the operating company, except to the extent of their capital accounts.

PZENA INVESTMENT MANAGEMENT, INC.
(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies

Basis of Presentation:

The consolidated financial statements are prepared in conformity with U.S. generally accepted accounting principles and related Securities and Exchange Commission rules and regulations. The Company's policy is to consolidate all majority-owned subsidiaries in which it has a controlling financial interest and variable interest entities where the Company is deemed to be the primary beneficiary ("Consolidated Subsidiaries"). Pursuant to the guidance of Emerging Issues Task Force Issue No. 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights* ("EITF 04-5"), the Company also consolidates non-variable-interest entities in which it acts as the general partner or managing member. All of these entities represent private investment partnerships over which the Company exercises or exercised control. Non-controlling interests recorded on the consolidated financial statements of the Company includes the non-controlling interests of the outside investors in each of these entities, as well as those of the operating company. All significant inter-company transactions and balances have been eliminated.

These consolidated investment partnerships are investment companies under the American Institute of Certified Public Accountants Audit and Accounting Guide for Investment Companies (the "AICPA Guide"). The Company has retained the specialized accounting for these partnerships pursuant to Emerging Issues Task Force Issue No. 85-12, *Retention of Specialized Accounting for Investments in Consolidation* ("EITF 85-12"). Thus, the Company reports the investment partnerships' investments in marketable securities and securities sold short at fair value, with net realized and unrealized gains and losses reported in earnings in the consolidated statements of operations.

Non-controlling interests in the operations of the Company's consolidated subsidiaries are comprised of the following:

	For the Three Months Ended June 30,	
	2008	2007
	(in thousands)	
Non-Controlling Interest of Pzena Investment Management, LLC	$ 12,735	$
Non-Controlling Interest in Consolidated Subsidiaries	(1,769)	646
Non-Controlling Interests	$ 10,966	$ 646

	For the Six Months Ended June 30,	
	2008	2007
	(in thousands)	
Non-Controlling Interest of Pzena Investment Management, LLC	$ 26,212	$
Non-Controlling Interest in Consolidated Subsidiaries	(3,669)	637
Non-Controlling Interests	$ 22,543	$ 637

As discussed further in Note 15, the Company has not recorded a non-controlling interest associated with the acquisition of its operating company, as the post offering net equity of the

PZENA INVESTMENT MANAGEMENT, INC.
(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (Continued)

operating company was less than zero. Pursuant to the guidance in Emerging Issues Task Force Issue No. 95-7, *Implementation Issues Related to the Treatment of Minority Interest in Certain Real Estate Trusts* ("EITF 95-7"), an operating company non-controlling interest will not be recorded until the initial deficit that existed at acquisition is extinguished.

The Company acts as the investment manager for four trusts and one offshore investment company, each of which are considered variable-interest entities. All of these entities are vehicles through which the Company offers its Global Value and/or International Value strategies. The Company is not considered the primary beneficiary of any of these entities. Correspondingly, their results of operations and financial condition are not consolidated by the Company. The total net assets of these variable-interest entities were approximately $882.8 million and $902.8 million at June 30, 2008 and December 31, 2007, respectively. The Company is not exposed to losses as a result of its involvement with these entities because it has no direct investment in them.

Investments in private investment partnerships in which the Company has a non-controlling interest and exercises significant influence are accounted for using the equity method. Such investments, if any, are reflected on the consolidated statements of financial condition as investments in affiliates and are recorded at the amount of capital reported by the respective private investment partnerships. Such capital accounts reflect the contributions paid to, distributions received from, and the equity earnings of, the private investment partnerships. The earnings of these private investment partnerships are included in equity in earnings/(loss) of affiliates in the consolidated statements of operations.

Prior to March 31, 2007, the operating company's membership units were categorized as either compensatory units or capital units. Because both types of units had features of both debt and equity, the operating company accounted for them pursuant to Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* ("FAS 123(R)"), and Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity* ("FAS 150"), as described further below.

Compensatory units consisted of units that were granted to employees and members for services rendered. Through March 31, 2007, the distributions associated with these units, and the subsequent incremental increase or decrease in their redemption value, were accounted for as part of compensation and benefits expense on the consolidated statements of operations, as further discussed below.

Capital units included units issued to founders and those purchased by certain employees. Through March 31, 2007, the distributions associated with these units, and the subsequent incremental increase or decrease in their redemption value, were accounted for as part of interest on mandatorily redeemable units on the consolidated statements of operations.

Effective March 31, 2007, the operating company amended its Operating Agreement to remove all mandatory redemption provisions. As all of its membership units thereafter had only equity characteristics, neither distributions, nor subsequent incremental changes to their value, were charged against income from the effective date of the amendment.

PZENA INVESTMENT MANAGEMENT, INC.
(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (Continued)

Management's Use of Estimates:

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

Fair Values of Financial Instruments:

The carrying amount of all financial instruments in the consolidated statements of financial condition, including investments in marketable securities, approximates their fair values.

Revenue Recognition:

Revenue, comprised of advisory fee income, is recognized over the period in which investment management services are provided. Advisory fee income includes management fees that are calculated based on percentages of assets under management, generally billed quarterly, either in arrears or advance, depending on their contractual terms. Advisory fee income also includes incentive fees that may be earned by the Company depending on the investment return of the assets under management. Incentive fee arrangements generally entitle the Company to participate, on a fixed-percentage basis, in any returns generated in excess of an agreed-upon benchmark. The Company's participation percentage in such return differentials is then multiplied by assets under management to determine the incentive fees earned. Returns are calculated on an annualized basis over the contract's measurement period, which may extend up to three years. Incentive fees are generally payable annually. Pursuant to the preferred accounting method under Emerging Issues Task Force Issue D-96, *Accounting for Management Fees Based on a Formula* ("EITF D-96"), such incentive fee income is recorded at the conclusion of the contractual performance period, when all contingencies are resolved. The Company recognized no such incentive fees for the three and six months ended June 30, 2008. For the three and six months ended June 30, 2007, the Company recognized incentive fees of $0.3 million and $0.4 million, respectively.

Unit-based Compensation:

Until March 31, 2007, compensation and benefits expense included the distributions made on compensatory units outstanding, as well as the incremental increases or decreases in the redemption values of these units subsequent to their grant date over their vesting period. Distributions were generally paid on the operating company's income before non-cash compensation charges. Redemption values were determined based on fair value.

PZENA INVESTMENT MANAGEMENT, INC.

(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (Continued)

The Operating Agreement was amended as of March 31, 2007 to eliminate the obligation to redeem units under any circumstance. Since all compensatory units thereafter had only equity characteristics, neither distributions, nor subsequent incremental changes to these units' value, were charged against income subsequent to March 31, 2007. In addition, as of March 31, 2007, the operating company accelerated the vesting of all compensatory units then subject to vesting. The operating company recorded a $65.0 million one-time charge in compensation and benefits expense associated with this acceleration as of March 31, 2007.

Interest on Mandatorily Redeemable Units:

Until the amendment of its Operating Agreement on March 31, 2007, the operating company recorded a net liability for its capital units equal to the accumulated redemption value as of the balance sheet date of all such outstanding units. This liability also included any undistributed earnings attributable to such units. As such, interest on mandatorily redeemable units included distributions made on capital units outstanding, as well as the incremental increases or decreases in the redemption values of these units. Distributions were generally paid on the operating company's income before non-cash compensation charges. Redemption values were determined based on fair value.

Prior to March 31, 2007, capital units were required to be redeemed on the death of a member. Effective March 31, 2007, the Operating Agreement was amended to eliminate the obligation to redeem units under any circumstance. Since all capital units thereafter had only equity characteristics, neither distributions, nor subsequent incremental changes to these units' value, were charged against income subsequent to the effective date of the amendment. The $16.6 million charge recorded in 2007 represents the distributions and incremental changes to these units' fair value through March 31, 2007.

Earnings per Share:

Prior to October 30, 2007, reported results of operations are solely those of Pzena Investment Management, LLC. Since the operating company is a private limited liability company, no historical earnings per share calculations have been reported prior to this date. Subsequent to October 30, 2007, earnings per share reflect the per share allocation of the Company's economic interest in its operating company.

Basic earnings per share is computed by dividing the Company's net income by the weighted-average number of shares outstanding during the reporting period. Diluted net income per share adjusts this calculation to reflect the impact of all outstanding operating company membership units, as well as outstanding operating company options and phantom units, to the extent that they would have a dilutive effect on net income per share for the reporting period. Net income for diluted earnings per share assumes all operating company membership units are converted into Company stock at the beginning of the reporting period and the resulting change to Company net income associated with its increased interest in the operating company is taxed at the Company's effective tax rate. For the three and six months ended June 30, 2008, 89,826 phantom operating units were included in the calculation of diluted net income per share. For the three and six months ended June 30, 2008, approximately 954,310 options to purchase operating company units freely convertible into Company common stock, were excluded from the calculation of diluted net income per share, as their inclusion would have had an antidilutive effect for both periods.

PZENA INVESTMENT MANAGEMENT, INC.

(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (Continued)

The Company's basic and diluted earnings per share, generated from its economic interest in the operating company, were determined as follows (in thousands, except for share and per-share amounts):

	For the Three Months Ended June 30, 2008
Net Income for Basic Earnings per Share	$ 780
Basic Weighted Average Shares Outstanding	6,123,494
Basic Earnings per Share	$ 0.13
Net Income for Diluted Earnings per Share	$ 8,124
Basic Weighted Average Shares Outstanding	6,123,494
Dilutive Effect of Operating Company Units	57,950,910
Dilutive Effect of Phantom Units	6,453
Diluted Weighted Average Shares Outstanding	64,080,857
Diluted Earnings per Share	$ 0.13

	For the Six Months Ended June 30, 2008
Net Income for Basic Earnings per Share	$ 1,600
Basic Weighted Average Shares Outstanding	6,121,590
Basic Earnings per Share	$ 0.26
Net Income for Diluted Earnings per Share	$ 16,722
Basic Weighted Average Shares Outstanding	6,121,590
Dilutive Effect of Operating Company Units	57,950,910
Dilutive Effect of Phantom Units	6,622
Diluted Weighted Average Shares Outstanding	64,079,122

Diluted Earnings per Share	$	0.26

Cash and Cash Equivalents:

The Company considers all highly-liquid debt instruments with an original maturity of three months or less at the time of purchase to be cash equivalents.

Interest on cash and cash equivalents is recorded as interest income on the consolidated statements of operations.

PZENA INVESTMENT MANAGEMENT, INC.

(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (Continued)

Due to/from Broker:

Due to/from broker consists primarily of cash balances and amounts receivable/payable for unsettled securities transactions held/initiated at the clearing brokers of the Company's consolidated investment partnerships.

Investments in Securities:

Investments in marketable securities and securities sold short represent primarily the securities held by the Company's consolidated investment partnerships. All such securities are recorded at fair value, with net realized and unrealized gains and losses reported in earnings in the consolidated statements of operations.

The Company adopted the provisions of Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* ("FAS 157"), on January 1, 2008. FAS 157 defines fair value as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. FAS 157 also establishes a framework for measuring fair value and a valuation hierarchy based upon the transparency of inputs used in the valuation of an asset or liability. Classification within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The valuation hierarchy contains three levels: (i) valuation inputs are unadjusted quoted market prices for identical assets or liabilities in active markets (Level 1); (ii) valuation inputs are quoted prices for identical assets or liabilities in markets that are not active, quoted market prices for similar assets and liabilities in active markets and other observable inputs directly or indirectly related to the asset or liability being measured (Level 2) and; (iii) valuation inputs are unobservable and significant to the fair value measurement (Level 3).

The Company's fair value measurements relate to its interest rate swap, as well as its investments in marketable securities and securities sold short, which are primarily exchange-traded securities with quoted prices in active markets. The fair value measurements of the securities have been classified as Level 1. The fair value measurement of the interest rate swap has been determined primarily based upon the market prices for interest rate swaps with similar provisions and forward interest rate curves, and has been classified as Level 2.

The following table presents these instruments' fair value at June 30, 2008 (in thousands):

	Level 1	Level 2	Level 3
Marketable Securities	$ 33,152	$	$
Securities Sold Short	(3,309)		
Interest Rate Swap		701	
Total Fair Value	$ 29,843	$ 701	$

Securities Valuation:

Investments in marketable equity securities and securities sold short which are traded on a national securities exchange are carried at fair value based on the last reported sales price on the valuation date. If no reported sales occurred on the valuation date, investments in securities are valued at the bid

PZENA INVESTMENT MANAGEMENT, INC.

(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (Continued)

price and securities sold short are valued at the ask price. Securities transactions are recorded on the trade date.

The net realized gain or loss on sales of securities and securities sold short is determined on a specific identification basis and is included in realized and unrealized gain/(loss), net on marketable securities and securities sold short in the consolidated statements of operations.

Concentrations of Credit Risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, amounts due from brokers and advisory fees receivable. The Company maintains its cash, temporary cash and restricted cash investments in bank deposits and other accounts whose balances, at times, exceed federally insured limits.

The concentration of credit risk with respect to advisory fees receivable is generally limited due to the short payment terms extended to clients by the Company. On a periodic basis, the Company evaluates its advisory fees receivable and establishes an allowance for doubtful accounts, if necessary, based on a history of past write-offs and collections and current credit conditions. For the three months ended June 30, 2008 and June 30, 2007, approximately 14.1% and 22.3%, respectively, of the Company's advisory fees were generated from an advisory agreement with one client. For the six months ended June 30, 2008 and 2007, fees generated from this agreement comprised 14.9% and 22.2%, respectively, of the Company's total advisory fees. At June 30, 2008 and December 31, 2007, no allowance for doubtful accounts has been deemed necessary.

Financial Instruments:

On February 28, 2008, the operating company entered into an interest rate swap agreement to manage its exposure to changes in interest rates associated with its three-year term loan facility. This instrument was not entered into for trading purposes. The counterparty to this agreement is a major financial institution. Pursuant to Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Certain Hedging Activities* ("FAS 133"), the Company records this cash flow hedge at fair value as a component of prepaid expenses and other assets on the consolidated statement of financial condition. The Company's pro rata share of the changes in the fair value of this agreement have been recorded as a component of accumulated other comprehensive income.

The Company assesses the effectiveness of this hedge using the hypothetical derivative method. Ineffectiveness is generally measured as the amount by which the cumulative change in the fair value of the hedging instrument exceeds the present value of the cumulative change in hedged item's cash flows. Ineffectiveness, if any, is reported in other income on the consolidated statements of operations. The Company's pro rata share of the gains and losses from this hedge will be reclassified from accumulated other comprehensive income to current period earnings when this hedged transaction affects earnings and will be included in interest expense on the consolidated statements of operations.

At June 30, 2008, the approximate fair value of this swap agreement was $0.7 million.

Property and Equipment:

Property and equipment is carried at cost, less accumulated depreciation and amortization. Depreciation is provided on a straight-line basis over the estimated useful lives of the respective assets,

PZENA INVESTMENT MANAGEMENT, INC.

(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (Continued)

which range from three to seven years. Leasehold improvements are amortized on a straight-line basis over the shorter of the useful life of the improvements or the remaining lease term.

Business Segments:

The Company views its operations as comprising one operating segment.

Income Taxes:

The Company is a "C" corporation under the Internal Revenue Code, and thus liable for federal, state and local taxes on the income derived from its economic interest in its operating company. The operating company is a limited liability company that has elected to be treated as a partnership for tax purposes. It has not made a provision for federal or state income taxes because it is the personal responsibility of each of the operating company's members (including the Company) to separately report their proportionate share of the operating company's taxable income or loss. Similarly, the income of the Company's consolidated investment partnerships is not subject to income taxes, as it is allocated to each partnership's individual partners. The operating company has made a provision for New York City Unincorporated Business Tax, or New York City UBT.

The Company and its consolidated subsidiaries account for all state, local and federal taxation pursuant to the asset and liability method, which requires deferred income tax assets and liabilities to be recorded for temporary differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the periods in which the temporary differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. At June 30, 2008 and December 31, 2007, no such valuation allowances were deemed necessary. The income tax provision, or credit, is the tax payable or refundable for the period, plus or minus the change during the period in deferred tax assets and liabilities.

Foreign Currency:

Investment securities and other assets and liabilities denominated in foreign currencies are translated into U.S. dollar amounts at the date of valuation. Purchases and sales of investment securities and income and expense items denominated in foreign currencies are translated into U.S. dollar amounts on the respective dates of such transactions.

The Company does not isolate that portion of the results of its operations resulting from changes in foreign exchange rates on investments from the fluctuations arising from changes in market prices of securities held. Such fluctuations are included in the net realized and unrealized gain/(loss), net on marketable securities and securities sold short in the consolidated statements of operations.

Reported net realized foreign exchange gains or losses arise from sales of foreign currencies, currency gains or losses realized between the trade and settlement dates on securities transactions, and the difference between the amounts of dividends, interest, and foreign withholding taxes recorded on the Company's books and the U.S. dollar equivalent of the amounts actually received or paid. Net unrealized foreign exchange gains and losses arise from changes in the fair values of assets and liabilities resulting from changes in exchange rates.

PZENA INVESTMENT MANAGEMENT, INC.

(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (Continued)

New Accounting Pronouncements:

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("FAS 159"). FAS 159 permits an entity to elect to measure certain financial instruments and certain other items at fair value with changes in fair value recognized in earnings. FAS 159 is effective for fiscal years beginning after November 15, 2007. Since the Company chose not to elect this fair value option, the impact of the adoption of this statement was not material.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* ("FAS 141R") which replaces Statement of Financial Accounting Standards No. 141, *Business Combinations*. FAS 141R establishes the principles and requirements for how an acquirer: (i) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree; (ii) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and (iii) discloses the business combination. FAS 141R applies to all transactions in which an entity obtains control of one or more businesses, including transactions that occur without the transfer of any type of consideration. FAS 141R is effective on a prospective basis for all business combinations on or after December 15, 2008, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies. Early adoption is not allowed. The Company is in the process of assessing the impact of this standard on its consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* ("FAS 160"). FAS 160 amends ARB No. 51 and establishes accounting and reporting standards that require non-controlling interests (previously referred to as minority interest) to be reported as a component of equity, changes in a parent's ownership interest while the parent retains its controlling interest be accounted for as equity transactions, and upon a loss of control, retained ownership interest will be remeasured at fair value, with any gain or loss recognized in earnings. FAS 160 is effective for the Company on January 1, 2009, except for the presentation and disclosure requirements, which will be applied retrospectively. Early adoption is not allowed. The Company is in the process of assessing the impact of this standard on its consolidated financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities* ("FAS 161"). FAS 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company is in the process of assessing the impact of this standard on its consolidated financial statements.

In June 2008, the FASB issued EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities". The EITF release states that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. The Company is in the process of assessing the impact of this standard on its consolidated financial statements.

PZENA INVESTMENT MANAGEMENT, INC.

(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 3 Property and Equipment

Property and equipment, net, is comprised of the following:

	As of June 30, 2008	As of December 31, 2007
	(in thousands)	
Computer Hardware	$ 836	$ 796
Computer Software	180	152
Furniture and Fixtures	1,161	1,156
Office Equipment	243	243
Leasehold Improvements	2,237	2,228
Total	4,657	4,575
Less: Accumulated Depreciation and Amortization	(1,645)	(1,412)
Total	$ 3,012	$ 3,163

Depreciation and amortization expense, included in general and administrative expenses, totaled $0.1 million for each of the three months ended June 30, 2008 and 2007. Such expenses totaled $0.2 million for each of the six months ended June 30, 2008 and 2007.

Note 4 Related Party Transactions

For the three and six months ended June 30, 2008, the Company earned $1.9 million and $3.7 million, respectively, in investment advisory fees from unconsolidated entities for which it acts as the investment manager. For the three and six months ended June 30, 2007, such advisory fees totaled $1.9 million and $3.5 million, respectively.

At June 30, 2008 and December 31, 2007, the Company had advanced $0.1 million to an international investment company for organization and start-up costs, which are included in receivable from related parties on the consolidated statements of financial condition. The Company is the sponsor and investment manager of this entity.

At June 30, 2008 and December 31, 2007, receivable from related parties included $0.1 million of loans to employees. These loans are in the form of forgivable promissory notes which are amortized through compensation expense pursuant to their terms.

Employees of the Company who are considered accredited investors have the ability to open separately-managed accounts, or invest in certain of the Company's consolidated investment partnerships, without being assessed advisory fees. Investments by employees in separately-managed accounts are permitted only at the discretion of the Executive Committee of the Company, but are generally not subject to the same minimum investment levels that are required of outside investors. Some of the investment advisory fees that are waived on separately managed accounts for employees are for strategies that typically have account fee minimums, which vary by strategy, but typically average approximately $50,000 per account per year.

PZENA INVESTMENT MANAGEMENT, INC.

(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 4 Related Party Transactions (Continued)

During the three months ended June 30, 2008, a shareholder who holds more than 10% of the Company's outstanding shares sold shares in transactions deemed to be short-swing sales. Under Section 16(b) of the Securities Exchange Act of 1934, the shareholder was required to disgorge to the Company the profits realized from the stock sales in the amount of $0.2 million. The Company recognized these proceeds as a capital contribution from a shareholder and reflected a corresponding increase to additional paid-in capital in its consolidated statements of changes in equity. Proceeds from these transactions did not affect the Company's consolidated statements of operations.

Note 5 Investments in Affiliates

The Company held an investment in, and acted as manager of, an unconsolidated investment partnership which was accounted for under the equity method. Summary financial information related to this entity is as follows:

	PAI Hedged Value Fund, LLC For the Three Months Ended June 30,	
	2008	2007
	(in thousands)	
Net Investment Income/(Loss)	$	$ (14)
Net Realized and Unrealized Loss		643
Net Income (Loss)	$	$ 629
Company's Equity in Income (Loss)	$	$ 187
Ownership Percentage	0%	30%

	PAI Hedged Value Fund, LLC For the Six Months Ended June 30,	
	2008	2007
	(in thousands)	
Net Investment Income (Loss)	$	$ (9)
Net Realized and Unrealized Income (Loss)		498
Net Income (Loss)	$	$ 489
Company's Equity in Income (Loss)	$	$ 145
Ownership Percentage	0%	30%

In the fourth quarter of 2007, the decision was made to dissolve the PAI Hedged Value Fund, LLC. This entity was consolidated beginning October 1, 2007, the effective date of the withdrawal of the external joint venture partner, until it was fully liquidated on December 28, 2007.

PZENA INVESTMENT MANAGEMENT, INC.

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Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 6 Commitments and Contingencies

In the normal course of business, the Company enters into agreements that include indemnities in favor of third parties, such as engagement letters with advisors and consultants. In certain cases, the Company may have recourse against third parties with respect to these indemnities. The Company maintains insurance policies that may provide coverage against certain claims under these indemnities. FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* ("FIN 45"), providing accounting and disclosure requirements for certain guarantees. The Company has had no claims or payments pursuant to these agreements, and it believes the likelihood of a claim being made is remote. Utilizing the methodology in FIN 45, the Company's estimate of the value of such guarantees is de minimis, and, therefore, an accrual has not been made in the consolidated financial statements.

In the normal course of business, the Company may be subject to various legal and administrative proceedings. On November 21, 2007 and January 16, 2008, respectively, substantively identical putative class action lawsuits were commenced in the United States District Court for the Southern District of New York against the Company and Richard S. Pzena, the Company's chief executive officer, seeking remedies under Section 11 of the Securities Act of 1933, as amended. The Court consolidated the lawsuits and appointed co-lead plaintiffs, who filed a consolidated amended complaint. The consolidated amended complaint names as defendants the Company, Richard S. Pzena, and two of the underwriters of our initial public offering, Goldman Sachs & Co., Inc. and UBS Securities LLC. Plaintiffs seek to represent a class of all persons who purchased or otherwise acquired Class A common stock issued pursuant or traceable to the Company's initial public offering. The consolidated amended complaint alleges that the registration statement and prospectus relating to the initial public offering of the Company's Class A common stock contained material misstatements and omissions and wrongfully failed to disclose net redemptions in the John Hancock Classic Value Fund, for which the Company acts as sub-investment advisor. The consolidated amended complaint seeks damages in an unspecified amount including rescission or rescissory damages. The Company believes that the allegations and claims are without merit and intends to contest these claims vigorously.

The Company leases office space under a non-cancelable operating lease agreement which expires on October 31, 2015. The Company reflects lease expense over the lease term on a straight-line basis. In early 2007, the Company agreed to lease additional office space at the Company's headquarters at 120 West 45th Street, New York, New York. The Company took possession of this space on March 1, 2007. The new lease is co-terminus with the Company's existing lease.

Lease expenses were $0.5 million for each of the three months ended June 30, 2008 and 2007. Such expenses totaled $1.0 million and $0.8 million for the six months ended June 30, 2008 and 2007, respectively.

Note 7 Retirement Plan

The Company maintains a defined contribution pension plan which covers substantially all members and employees. The Company may make contributions to the plan at the discretion of management. Under the terms of the plan, all such contributions vest immediately. Company contributions for the three months ended June 30, 2008 and 2007 were $0.4 million and $0.3 million, respectively. Such contributions totaled $0.9 million for each of the six months ended June 30, 2008

PZENA INVESTMENT MANAGEMENT, INC.

(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 7 Retirement Plan (Continued)

and 2007. These expenses are included in compensation and benefits expense in the consolidated statements of operations.

Note 8 Compensation and Benefits

As discussed further in Note 14, the operating company issued compensatory units to employees and members which had redemption features that required them to be classified as liabilities in the consolidated statements of financial condition prior to March 31, 2007. Until this date, distributions on the compensatory units outstanding, and changes in these units' redemption values, were recorded as compensation and benefits expense.

Compensation and benefits expense to employees and members is comprised of the following:

	For the Three Months Ended June 30,	
	2008	2007
	(in thousands)	
Cash Compensation and Other Benefits	$ 8,373	$ 8,533
Distributions on Compensatory Units		
Change in Redemption Value of Compensatory Units		
Acceleration of Vesting of Compensatory Units		
Other Non-Cash Compensation	289	49
Total Compensation and Benefits Expense	$ 8,662	$ 8,582

	For the Six Months Ended June 30,	
	2008	2007
	(in thousands)	
Cash Compensation and Other Benefits	$ 16,980	$ 17,432
Distributions on Compensatory Units		12,087
Change in Redemption Value of Compensatory Units		15,969
Acceleration of Vesting of Compensatory Units		64,968
Other Non-Cash Compensation	633	1,950
Total Compensation and Benefits Expense	$ 17,613	$ 112,406

Distributions on compensatory units includes cash distributions paid on, as well as the net increase or decrease in undistributed earnings attributable to, compensatory units.

As of March 31, 2007, the effective date of the amendment to the Operating Agreement to eliminate the operating company's obligation to redeem units under any circumstance, the unit-based compensation awards previously categorized as liabilities were reclassified as equity. Further, as of March 31, 2007, the operating company accelerated the vesting of all compensatory units then subject to vesting. Subsequent to this date, distributions on these units are not considered a component of compensation and benefits expense and are instead recorded as a direct

reduction of members' capital.

PZENA INVESTMENT MANAGEMENT, INC.
(Prior to October 30, 2007, Pzena Investment Management, LLC)

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 8 Compensation and Benefits (Continued)

The change in liability for the redemption of compensatory units, through the date of the amendment of the Operating Agreement described above, is as follows (in thousands):

Balance at December 31, 2006	$ 263,980
Value of Units Vested During the Year	79,199
Increase in Value of Units Previously Vested	1,738
Change in Undistributed Earnings	
Compensation Expense Associated with Unvested Units	
Payment of Liabilities	(953)
Reclassification due to Amendment of Operating Agreement	(343,964)
Balance at March 31, 2007	$

For the three months ended June 30, 2007, the operating company granted 15,000 options to purchase capital units pursuant to the Pzena Investment Management, LLC 2006 Equity Incentive Plan. No such grants occurred for the three months ended June 30, 2008. For the six months ended June 30, 2008 and 2007, the operating company granted 446,000 and 645,000 options, respectively, to purchase capital units. These options had varying vesting schedules and were issued at strike prices equal to the assessed fair market value per unit at the time of award issuance. The Company determined that the total grant-date fair value of the options awarded during the three months ended June 30, 2007 was less than $0.1 million. The total grant-date fair value of the options awarded during the six months ended June 30, 2008 and 2007 was approximately $1.2 million and $2.0 million, respectively. For the three and six months ended June 30, 2008, the Company recognized approximately $0.1 million, respectively, in compensation and benefits expense associated with the amortization of these awards. For the three months ended June 30, 2007, such amortization was less than $0.1 million. For the six months ended June 30, 2007, such amortization totaled approximately $2.0 million.

Pursuant to the operating company's bonus plan, which became effective January 1, 2007, eligible employees whose cash compensation is in excess of certain thresholds have a portion of that excess mandatorily deferred. Amounts deferred may be credited to an investment account or take the form of phantom Class B units, at the employee's discretion, and vest ratably over four years commencing January 1, 2008. At June 30, 2008, the liability associated with such investment accounts was approximately $0.3 million, and has been included as a component of other liabilities on the consolidated statement of financial condition. For the three and six months ended June 30, 2008, the Company recognized approximately $0.2 and $0.5 million, respectively, in compensation and benefits expense associated with the amortization of these awards.

Note 9 Short Term Borrowings

Simultaneously with the three year term loan agreement described below, on July 23, 2007, the Company obtained a $20.0 million revolving credit facility, which will expire on July 23, 2010, in order to finance its short term working capital needs. This facility carries a commitment fee of 0.2% on any unused amounts. On February 11, 2008, the operating company entered into Amendment No.1 to its three-year term loan facility. The amendment changed a number of credit agreement provisions,

PZENA INVESTMENT MANAGEMENT, INC.
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Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 9 Short Term Borrowings (Continued)

including reducing the capacity of the revolving credit facility from $20.0 million to $5.0 million. As of and for the period ended June 30, 2008, and as of December 31, 2007, no balance was outstanding against the facility.

Note 10 Long Term Debt

On July 23, 2007, the operating company entered into a $60.0 million, three-year term loan agreement, the proceeds of which were used to finance a one-time distribution to its members. The principal amount borrowed bears interest at a variable rate based, at the Company's option, on (i) the one, two, three, six, nine or twelve-month LIBOR rate plus 1.00%, or (ii) the higher of the lender's prime rate and the Federal Funds Rate. The principal amount is payable in full at the end of the three-year term, with no penalty for prepayment. On February 11, 2008, the operating company entered into Amendment No.1 to its three-year term loan facility. The agreement, as amended, requires the operating company to maintain assets under management of at least $15.0 billion and generate consolidated earnings before interest, taxes, depreciation and amortization ("EBITDA"), as defined, of at least $40.0 million in any consecutive four fiscal quarter period. Pursuant to the terms of the amended agreement, term loan amortization is required beginning in any period when assets under management are less than $20.0 billion and ending when assets under management are greater than $21.5 billion. Further, an excess cash flow sweep is required if assets under management are below $17.5 billion. For the period from February 11, 2008 through July 23, 2008, the interest rate in effect will be 6.91%, which is equal to the twelve-month LIBOR rate in effect at the time of the closing of the agreement of 5.41%, plus 1.50%. Approximately $0.1 million in debt issuance costs were incurred in association with this loan. Such costs have been recorded in prepaid expenses and other assets on the consolidated statements of financial condition and are being amortized over the term of the loan.

During the three months ended June 30, 2008, the Company's assets under management fell below $20 billion. Pursuant to the provisions of the term loan, as amended, the Company was required to make an amortization payment of $3.0 million on June 30, 2008.

Note 11 Interest Rate Swap

The Company manages its exposure to changes in market rates of interest. The Company's use of derivative instruments is limited to an interest rate swap used to manage the interest rate exposure related to its three-year term loan facility. The Company monitors its position and the credit rating of the counterparty and does not anticipate non-performance by such counterparty. The interest rate swap agreement was not entered into for trading purposes.

On February 28, 2008, the operating company entered into a $60.0 million notional amount interest rate swap agreement that commences on July 23, 2008. The swap, which expires on the same date as the operating company's three-year term loan facility, obligates the operating company to pay a 2.825% fixed rate of interest on the notional amount and requires the counterparty to pay the operating company a floating interest rate based on the monthly LIBOR interest rate. The 1.50% spread on the term loan is in addition to these amounts, resulting in an aggregate annualized fixed payment of 4.325% of the notional amount for the term of the swap agreement. For the six months

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Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 11 Interest Rate Swap (Continued)

ended June 30, 2008, the Company recognized $0.1 million in other accumulated comprehensive income associated with its pro rata share of the change in fair value of this swap agreement.

Concurrently with the amortization of the term loan described above, on June 30, 2008, the Company reduced the notional amount of its interest rate swap by $3.0 million dollars. The proceeds received from the counterparty in exchange for this reduction were less than $0.1 million. Additional loan amortization is required until the Company's assets under management exceed $21.5 billion.

Note 12 Income Taxes

The operating company is a limited liability company that has elected to be treated as a partnership for tax purposes. Neither it nor the Company's other consolidated subsidiaries has made a provision for federal or state income taxes because it is the personal responsibility of each of these entities' members (including the Company) to separately report their proportionate share of the respective entity's taxable income or loss. The operating company has made a provision for New York City UBT. Subsequent to the offering and reorganization on October 30, 2007, the Company, as a "C" corporation under the Internal Revenue Code, is liable for federal, state and local taxes on the income derived from its economic interest in its operating company, which is net of UBT. Correspondingly, in its consolidated financial statements, the Company reports both the operating company's provision for UBT as well as its provision for federal, state and local corporate taxes. The components of the provision for income taxes are as follows:

	For the Three Months Ended June 30,	
	2008	2007
	(in thousands)	
Current Provision:		
Unincorporated Business Tax	$ 939	$ 1,241
Local Corporate Tax		
State Corporate Tax		
Federal Corporate Tax		
Total Current Provision	$ 939	$ 1,241

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Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 12 Income Taxes (Continued)

	For the Three Months Ended June 30,
	2008