

DIAMOND HILL INVESTMENT GROUP INC

Form 10-Q

May 03, 2013

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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 March 31, 2013

Commission file number 000-24498

DIAMOND HILL INVESTMENT GROUP, INC.

(Exact name of registrant as specified in its charter)

Ohio
(State of)

65-0190407
(I.R.S. Employer)

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incorporation)

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 April 30, 2013, is 3,249,472 shares.

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

	3/31/2013 (Unaudited)	12/31/2012
ASSETS		
Cash and cash equivalents	\$ 5,399,980	\$ 7,870,908
Investment portfolio	18,393,156	16,503,731
Accounts receivable	11,519,318	10,438,598
Prepaid expenses	1,087,873	953,526
Furniture and equipment, net of depreciation	970,534	745,476
Income tax receivable	1,593,238	2,271,704
Deferred taxes	2,138,899	2,451,974
Total assets	\$ 41,102,998	\$ 41,235,917
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Accounts payable and accrued expenses	\$ 2,224,043	\$ 2,797,483
Accrued incentive compensation	4,857,000	15,908,083
Deferred compensation liability	863,499	794,644
Total liabilities	7,944,542	19,500,210
Commitments and contingencies		
Shareholders' Equity		
Common stock, no par value		
7,000,000 shares authorized;		
3,242,674 issued and outstanding at March 31, 2013 (inclusive of 329,988 unvested shares);		
3,169,987 issued and outstanding at December 31, 2012 (inclusive of 319,988 unvested shares)	70,907,335	65,255,813
Preferred stock, undesignated, 1,000,000 shares authorized and unissued		
Deferred equity compensation	(14,388,976)	(14,829,470)
Accumulated deficit	(23,359,903)	(28,690,636)
Total shareholders' equity	33,158,456	21,735,707
Total liabilities and shareholders' equity	\$ 41,102,998	\$ 41,235,917
Book value per share	\$ 10.23	\$ 6.86

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

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

	Three Months Ended March 31,	
	2013	2012
REVENUES:		
Investment advisory	\$ 15,853,994	\$ 14,375,094
Mutual fund administration, net	2,502,180	2,239,126
Total revenue	18,356,174	16,614,220
OPERATING EXPENSES:		
Compensation and related costs	9,513,412	8,487,509
General and administrative	1,278,068	1,136,391
Sales and marketing	382,043	310,626
Third party distribution	147,443	213,408
Mutual fund administration	407,593	445,746
Total operating expenses	11,728,559	10,593,680
NET OPERATING INCOME	6,627,615	6,020,540
Investment income	1,824,659	1,271,731
INCOME BEFORE TAXES	8,452,274	7,292,271
Income tax provision	(3,121,541)	(2,680,918)
NET INCOME	\$ 5,330,733	\$ 4,611,353
Earnings per share	\$ 1.67	\$ 1.52
Weighted average shares outstanding	3,197,476	3,030,834

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

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

	Three Months Ended March 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$ 5,330,733	\$ 4,611,353
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation on furniture and equipment	80,199	85,265
Stock-based compensation	1,486,008	1,329,009
Increase in accounts receivable	(1,080,720)	(590,013)
Change in deferred income taxes	313,075	297,010
Investment gain/loss, net	(1,889,425)	(1,265,356)
Decrease in accrued compensation	(6,376,220)	(6,849,702)
Excess income tax benefit from stock-based compensation		(9,445)
Decrease in accounts payable and accrued expenses	(573,440)	(600,729)
Other changes in assets and liabilities	544,119	230,148
Net cash used in operating activities	(2,165,671)	(2,762,460)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of furniture and equipment	(305,257)	(37,040)
Cost of investments purchased and other portfolio activity		(2,365,000)
Net cash used in investing activities	(305,257)	(2,402,040)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of taxes withheld on employee stock transactions		(363,925)
Excess income tax benefit from stock-based compensation		9,445
Net cash used in financing activities		(354,480)
CASH AND CASH EQUIVALENTS		
Net change during the period	(2,470,928)	(5,518,980)
At beginning of period	7,870,908	15,242,768
At end of period	\$ 5,399,980	\$ 9,723,788
Supplemental cash flow information:		
Interest paid	\$	\$
Income taxes paid	2,130,000	2,163,000
Supplemental disclosure of non-cash transactions:		
Common stock issued as incentive compensation	4,606,008	5,540,792

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

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Diamond Hill Investment Group, Inc.

Notes to Consolidated Financial Statements (unaudited)

Note 1 Business and Organization

Diamond Hill Investment Group, Inc. (the Company) derives its consolidated revenues and net income primarily from investment advisory and fund administration services. The Company has three operating subsidiaries.

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

Beacon Hill Fund Services, Inc. (BHFS), an Ohio corporation, is a wholly owned subsidiary of the Company. BHFS provides certain compliance, treasury, and other fund administration services to mutual fund companies. BHIL Distributors, Inc. (BHIL), an Ohio corporation, is a wholly owned subsidiary of BHFS. BHIL provides underwriting services to mutual funds. BHFS and BHIL collectively operate as Beacon Hill.

Note 2 Significant Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses for the periods. Actual results could differ from those estimates. Certain prior period amounts and disclosures have been reclassified to conform to the current period financial presentation. Book value per share is computed by dividing total shareholders' equity by the number of shares issued and outstanding at the end of the measurement period. 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 in one business segment, namely providing investment management and administration services to mutual funds, institutional accounts, and private investment 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 mutual funds.

Table of ContentsNote 2 Significant Accounting Policies (Continued)Accounts Receivable

Accounts receivable are recorded when they are due and are presented on 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 either March 31, 2013 or December 31, 2012.

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. 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. The following table summarizes the values of the Company's investments based upon Level 1 and Level 2 inputs as of March 31, 2013 and December 31, 2012:

	March 31, 2013	December 31, 2012
Level 1 Inputs	\$ 16,471,023	\$ 16,922,720
Level 2 Inputs	3,922,269	3,650,561

Level 1 investments are all registered investment companies (mutual funds) and include \$2.0 million and \$4.1 million, respectively, of money market mutual funds that the Company classifies as cash equivalents. Level 2 investments are all limited partnerships. There were no transfers in or out of the levels.

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

Limited Partnership Interests

DHCM is the managing member of Diamond Hill General Partner, LLC (the "General Partner"), the general partner of Diamond Hill Investment Partners, L.P. ("DHIP"), Diamond Hill Research Partners International, L.P. ("DHRPI"), and Diamond Hill Valuation-Weighted 500, L.P. ("DHVW"), formerly Diamond Hill Valuation-Based Index, L.P., collectively (the "Partnerships"), each a limited partnership whose underlying assets consist of marketable securities.

DHCM, in its role as managing member of the General Partner, has the power to direct each Partnership's economic activities and the right to receive investment advisory and performance incentive fees that may be significant to the Partnerships. The Company evaluated these Partnerships to determine whether or not to consolidate the entities in accordance with FASB ASC 810, *Consolidation*. Certain of these Partnerships are considered to be variable interest entities ("VIEs") while others are considered to be voting rights entities ("VREs"), both of which are subject to consolidation consideration. The Company would consolidate VIEs where the Company is considered the primary beneficiary or VREs where the General Partner is considered to control the Partnership. For the Partnerships that were considered VIEs, the Company was not deemed to be the primary beneficiary. For the Partnerships that were considered VREs, it was determined that the DHCM in its role of managing member of the General Partner did not control the Partnerships. Therefore, the investments are accounted for under the equity method rather than being consolidated in the accompanying financial statements.

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Note 2 Significant Accounting Policies (Continued)

Limited Partnership Interests (Continued)

DHCM's investments in these Partnerships are reported as a component of the Company's investment portfolio, valued at DHCM's proportionate interest in the net asset value of the marketable securities held by

the Partnerships. Gains and losses attributable to changes in the value of DHCM's interests in the Partnerships are included in the Company's reported investment income.

The Company's exposure to loss as a result of its involvement with the Partnerships is limited to the amount of its investments. DHCM is not obligated to provide financial or other support to the Partnerships, other than its investments to date and its contractually provided investment advisory responsibilities, and has not provided such support. The Company has not provided liquidity arrangements, guarantees or other commitments to support the Partnerships' operations, and the Partnerships' creditors and interest holders have no recourse to the general credit of the Company.

Certain board members, officers and employees of the Company invest in DHIP. These individuals receive no remuneration as a result of their personal investment in the Partnership. The capital of the General Partner 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.

Deferred Compensation Liability

Deferred compensation liability represents compensation that will be paid out upon satisfactory completion of certain performance-based criteria specified in employee award agreements issued pursuant to the 2011 Equity and Cash Incentive Plan. See Note 5.

Revenue Recognition – General

The Company earns substantially all of its revenue from investment advisory and fund administration services. Mutual fund investment advisory and administration fees, generally calculated as a percentage of assets under management (AUM), 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 periodic variable incentive fees.

Revenue Recognition – Incentive Revenue

The Company manages certain client accounts that provide for variable incentive fees. These fees are based on investment results over rolling five-year periods. For variable 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 measurement 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 measurement period for the specific client which the incentive fee applies. The table below shows AUM subject to incentive fees and the incentive fees, as calculated under each of the above methods:

Table of ContentsNote 2 Significant Accounting Policies (Continued)Revenue Recognition – Incentive Revenue (Continued)

	As Of March 31,	
	2013	2012
AUM Contractual Period Ends:		
Calendar Quarter-End	\$	\$ 88,802,491
Calendar Year-End		87,002,132
May 31, 2017	306,975,487	
Total AUM Subject to Incentive Fees	\$ 306,975,487	\$ 175,804,623

	For The Three Months Ending March 31,	
	2013	2012
Incentive Fees Under Method 1 -		
Contractual Period Ends:		
Calendar Quarter-End	\$	\$
Calendar Year-End		
May 31, 2017		
Total Incentive Fees Under Method 1	\$	\$
Incentive Fees Under Method 2 -		
Contractual Period Ends:		
Calendar Quarter-End	\$	\$
Calendar Year-End		
May 31, 2017	1,146,468	
Total Incentive Fees Under Method 2	\$ 1,146,468	\$

Revenue Recognition – Mutual Fund Administration

DHCM has an administrative and transfer agency services agreement with 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 pays DHCM a fee, which is calculated using the following annual rates times the average daily net assets of each respective fund and share class:

	Prior to February 29, 2012	After February 29, 2012
Class A and Class C	0.26%	0.25%
Class I	0.24%	0.25%
Class Y	0.10%	0.10%

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, federal and state registrations, and legal and audit services. 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 each Fund pays to DHCM is reviewed annually

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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, in accordance with FASB ASC 605-45, *Revenue Recognition - Principal Agent Considerations*. In addition, DHCM finances the upfront commissions which are paid to brokers who sell Class C shares of the Funds. As financier, DHCM advances 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 repayments DHCM receives from the principal underwriter to recoup this commission advancement.

Table of ContentsNote 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 on the Consolidated Statements of Income. 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, in accordance with the appropriate accounting treatment for this agency relationship.

Mutual fund administration gross and net revenue are summarized below:

	Three Months Ended March 31,	
	2013	2012
Mutual fund administration:		
Administration revenue, gross	\$ 3,615,730	\$ 3,109,859
12b-1/service fees and commission revenue received from fund clients	1,812,388	1,729,352
12b-1/service fees and commission expense payments to third parties	(1,588,813)	(1,358,249)
Fund related expense	(1,339,773)	(1,242,997)
Revenue, net of fund related expenses	2,499,532	2,237,965
DHCM C-Share financing:		
Broker commission advance repayments	56,658	62,407
Broker commission amortization	(54,010)	(61,246)
Financing activity, net	2,648	1,161
Mutual fund administration revenue, net	\$ 2,502,180	\$ 2,239,126

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.

Table of ContentsNote 2 Significant Accounting Policies (Continued)Income Taxes

The Company accounts for income taxes through an asset and liability approach. Deferred taxes are provided on an asset and liability method, whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Deferred tax assets are reduced by a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Company is subject to examination by various federal, state and local jurisdictions for various tax periods. The Company's income tax positions are based on research and interpretations of the income tax laws and rulings in each of the jurisdictions in which the Company does business. Due to the subjectivity of interpretations of laws and rulings in each jurisdiction, the differences and interplay in tax laws between those jurisdictions, as well as the inherent uncertainty in estimating the final resolution of complex tax audit matters, the Company's estimates of income tax liabilities may differ from actual payments or assessments. The Company regularly assesses its position with regard to tax exposures and records liabilities for these uncertain tax positions and related interest and penalties, if any, according to the principles of FASB ASC 740, *Income Taxes*. As of March 31, 2013, the Company has not recorded any liability for uncertain tax positions.

Earnings Per Share

Earnings per share (EPS) is computed by dividing net income by the weighted average number of common shares outstanding for the period. For the periods presented, the Company has unvested stock-based payment awards that contain nonforfeitable rights to dividends. For the periods presented, the Company does not have dilutive securities outstanding.

Note 3 Investment Portfolio

As of March 31, 2013, the Company held investments (excluding money market funds, which are included with cash and cash equivalents) worth \$18.4 million and an estimated cost basis of \$12.4 million. The following table summarizes the market value of these investments:

	March 31, 2013	December 31, 2012
Diamond Hill Small Cap Fund	\$ 251,304	\$ 215,550
Diamond Hill Small-Mid Cap Fund	279,021	239,316
Diamond Hill Large Cap Fund	275,432	246,744
Diamond Hill Select Fund	278,021	242,252
Diamond Hill Long-Short Fund	1,125,816	1,036,045
Diamond Hill Research Opportunities Fund	12,046,118	10,658,665
Diamond Hill Strategic Income Fund	215,175	214,598
Diamond Hill Investment Partners, L.P.	8,267	7,336
Diamond Hill Research Partners International, L.P.	1,438,872	1,384,976
Diamond Hill Valuation-Weighted 500, L.P. ^(a)	2,475,130	2,258,249
Total Investment Portfolio	\$ 18,393,156	\$ 16,503,731

(a) Diamond Hill Valuation-Weighted 500, L.P. was formerly Diamond Hill Valuation-Based Index, L.P.

Table of ContentsNote 3 Investment Portfolio (Continued)

DHCM is the managing member of 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. Summary financial information, including the Company's carrying value and income from the Partnerships, is as follows:

	March 31, 2013	As of December 31, 2012
Total partnership assets	\$ 118,895,434	\$ 105,472,952
Total partnership liabilities	21,239,354	17,786,579
Net partnership assets	\$ 97,656,080	\$ 87,686,373
DHCM's portion of net assets	\$ 3,922,269	\$ 3,650,561
	For the Three Months Ended March 31, 2013	For the Year Ended December 31, 2012
Net partnership income	\$ 10,664,931	\$ 15,054,951
DHCM's portion of net income	\$ 271,448	\$ 472,659

Note 4 Capital StockCommon Shares

The Company has only one class of securities outstanding, Common Shares, no par value per share.

Authorization of Preferred Shares

The Company's Amended and Restated 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 preferred shares issued or outstanding at either March 31, 2013 or December 31, 2012.

Note 5 Stock-Based CompensationEquity Incentive Plans*2011 Equity and Cash Incentive Plan*

At the Company's annual shareholder meeting on April 26, 2011, shareholders approved the 2011 Equity and Cash Incentive Plan (2011 Plan). The 2011 Plan is intended to facilitate the Company's ability to attract and retain staff, provide additional incentives to employees, directors and consultants, and promote the success of the Company's business. The 2011 Plan authorizes the issuance of 600,000 Common Shares of the Company in various forms of equity awards. The 2011 Plan also authorizes cash incentive awards. As of March 31, 2013, there were 244,570 Common Shares available for awards under the 2011 Plan. The 2011 Plan provides that the Board of Directors, or a committee appointed by the Board, may grant awards and otherwise administer the 2011 Plan. Restricted stock grants issued under the 2011 Plan, which vest over time, are recorded as deferred compensation in the equity section of the balance sheet on the grant date and then recognized as compensation expense based on the grant date price over the vesting period of the respective grant.

Table of ContentsNote 5 Stock-Based Compensation (Continued)*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). There are no longer any Common Shares available for future issuance under the 2005 Plan, although outstanding grants under the 2005 Plan remain issued and outstanding. Restricted stock grants issued under the 2005 Plan, which vest over time, are recorded as deferred compensation in the equity section of the balance sheet on the grant date and then recognized as compensation expense based on the grant date price over the vesting period of the respective grant.

Restricted Stock Grant Transactions

The following table represents a roll-forward of outstanding restricted stock grants issued pursuant to the 2011 and 2005 Plans and related activity during the year ended December 31, 2012 and the three months ended March 31, 2013:

	Shares	Weighted-Average Grant Date Price per Share
Outstanding restricted stock grants as of December 31, 2011	260,621	\$ 73.78
Grants issued	107,600	75.64
Grants vested	(46,056)	75.22
Grants forfeited	(2,177)	71.37
Outstanding restricted stock grants as of December 31, 2012	319,988	\$ 74.22
Grants issued	10,000	77.81
Grants vested		
Grants forfeited		
Total outstanding restricted stock grants as of March 31, 2013	329,988	\$ 74.33

The total outstanding restricted stock grants shown above are included in issued and outstanding shares. Total deferred compensation related to unvested restricted stock grants was \$14,388,976 as of March 31, 2013. Expense recognition of deferred compensation over the remaining vesting periods is as follows:

Nine Months

Remaining In

2013	2014	2015	2016	2017	2018	Total
\$ 3,565,008	\$ 4,504,668	\$ 3,600,176	\$ 1,760,806	\$ 919,413	\$ 38,905	\$ 14,388,976

401(k) Plan

The Company sponsors a 401(k) plan in which all employees participate. 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. The following table summarizes the Company's expenses attributable to the plan during the

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three months ended March 31, 2013 and 2012:

	March 31, 2013	March 31, 2012
Three Months Ended	\$ 280,213	\$ 252,919

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The Company leases approximately 25,500 square feet of office space at two locations. The following table summarizes the total lease and operating expenses for the three months ended March 31, 2013 and 2012:

	March 31, 2013	March 31, 2012
Three Months Ended	\$ 175,888	\$ 170,379

The approximate future minimum lease payments under the operating leases are as follows:

Nine Months

Remaining In

2013	2014	2015	2016	Thereafter
\$341,000	\$ 454,000	\$ 401,000	\$ 234,000	\$

In addition to the above rent, the Company is also responsible for normal operating expenses of the properties. Such operating expenses were approximately \$9.69 per square foot in 2012, on a combined basis, and are expected to be approximately \$9.80 per square foot in 2013.

Note 7 Income Taxes

The provision for income taxes for the three months ended March 31, 2013 and 2012 consists of federal, state and city income taxes. The effective tax rates for the three months ended March 31, 2013 and 2012 were 36.9% and 36.8%, respectively. During 2012, the Company determined it was entitled to a tax deduction related to dividends paid on unvested restricted stock. The resulting tax benefit of \$1.9 million was recorded as a reduction of income taxes payable and an increase in shareholders' equity.

The net temporary differences incurred to date will reverse in future periods as the Company generates taxable earnings. The Company believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize the net deferred tax assets recorded. The Company records a valuation when it is more likely than not that some portion of all of the deferred tax assets will not be realized. As of March 31, 2013 and December 31, 2012, no valuation allowance was deemed necessary.

FASB ASC 740, *Income Taxes*, prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company did not record an accrual for tax related uncertainties or unrecognized tax positions as of March 31, 2013 and December 31, 2012. The Company does not expect a change to the reserve for uncertain tax positions within the next twelve months that would have a material impact on the consolidation financial statements.

The Company files income tax returns in the federal and all applicable state and local jurisdictions. The Company is subject to federal, state and local examinations by tax authorities for tax years ended December 31, 2009 through 2012.

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

The following table sets forth the computation for EPS:

	Three Months Ended March 31,	
	2013	2012
Net income	\$ 5,330,733	\$ 4,611,353
Weighted average number of outstanding shares	3,197,476	3,030,834
Earnings per share	\$ 1.67	\$ 1.52

For the periods presented, the Company has invested stock-based payment awards that contain nonforfeitable rights to dividends and are included in the computation of basic EPS above as participating shares. For the periods presented, the Company does not have dilutive securities outstanding.

Note 9 Regulatory Requirements

BHIL, a wholly owned subsidiary of the Company and principal underwriter for mutual funds, is subject to the U.S. Securities and Exchange Commission (SEC) uniform net capital rule, which requires the maintenance of minimum net capital. BHIL's net capital exceeded its minimum net capital requirement at March 31, 2013 and December 31, 2012. The net capital balances, minimum net capital requirements, and ratios of aggregate indebtedness to net capital for BHIL are summarized below as of March 31, 2013 and December 31, 2012:

	March 31,	December 31,
	2013	2012
Net Capital	\$ 390,290	\$ 354,029
Minimum Net Capital Requirement	49,681	46,597
Ratio of Aggregate Indebtedness to Net Capital	1.91 to 1	1.97 to 1

Note 10 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 11 Subsequent Event

On April 10, 2013 a client notified the Company that in connection with a recently announced acquisition, it would be replacing DHCM and another unaffiliated adviser, as the sub-advisers on two accounts in June 2013. The revenue generated from two accounts currently represents approximately 2.6% of the Company's annualized revenue.

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

Forward-looking Statements

Throughout this Quarterly Report on Form 10-Q, Diamond Hill Investment Group, Inc. may make forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), 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, intend and similar expressions in this report are 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; changes in national and local economic and political conditions, including the effects of implementation of the Budget Control Act of 2011 and the American Taxpayer Relief Act of 2012 and the continuing economic uncertainty in various parts of the world; 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 other public documents on file with the U. S. Securities and Exchange Commission (SEC), including those discussed below in Item 1A of Part II. When we use the terms the Company, management, we, us, and our, we mean Diamond Hill Investment Group, Inc. and its subsidiaries.

General

The Company, an Ohio corporation organized in April 1990, derives its consolidated revenue and net income from investment advisory and fund administration services provided by its subsidiaries DHCM, BHFS, and BHIL. BHFS and BHIL collectively operate as Beacon Hill. DHCM is a registered investment adviser under the Investment Advisers Act of 1940. DHCM sponsors, distributes, and provides investment advisory and related services to various U.S. and foreign clients through the Funds, institutional accounts, and private investment funds (generally known as hedge funds). Beacon Hill provides fund administration and statutory underwriting services to various clients, including the Funds.

The Company's primary objective is to fulfill its fiduciary duty to clients. Its secondary objective is to grow the intrinsic value of the Company in order to achieve an adequate long-term return for shareholders.

In this section, the Company discusses and analyzes the consolidated results of operations for the three month periods ended March 31, 2013 and 2012 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, 2012. 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 month period ended March 31, 2013 are not necessarily indicative of the results which may be expected for the entire fiscal year.

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The Company's revenue is derived primarily from investment advisory and administration fees. Investment advisory and administration fees paid to the Company are generally based 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's primary expense is employee compensation and benefits.

Revenues are highly dependent on both the value and composition of AUM. The following is a summary of the Company's AUM by product, investment objective, and a roll-forward of the change in AUM for the three months ended March 31, 2013 and 2012:

(in millions)	Assets Under Management by Product		
	As of March 31,		
	2013	2012	% Change
Proprietary funds	\$ 5,964	\$ 4,856	23%
Sub-advised funds	1,030	1,008	2%
Institutional accounts	3,580	3,496	2%
Total AUM	\$ 10,574	\$ 9,360	13%

(in millions)	Assets Under Management by Investment Objective		
	As of March 31,		
	2013	2012	% Change
Small Cap	\$ 1,082	\$ 997	9%
Small-Mid Cap	460	299	54%
Large Cap	5,801	5,244	11%
Select (All Cap)	285	355	-20%
Long-Short	2,747	2,277	21%
Strategic Income	199	188	6%
Total AUM	\$ 10,574	\$ 9,360	13%

(in millions)	Change in Assets Under Management For the Three Months Ended March 31,	
	2013	2012
AUM at beginning of the period	\$ 9,429	\$