

DIAMOND HILL INVESTMENT GROUP INC

Form 10-Q

July 29, 2011

Table of Contents

**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 June 30, 2011
Commission file number 000-24498
DIAMOND HILL INVESTMENT GROUP, INC.
(Exact name of registrant as specified in its charter)**

Ohio

65-0190407

(State of incorporation)

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

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

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

(614) 255-3333

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes: No:

The number of shares outstanding of the issuer's common stock, as of July 27, 2011, is 3,003,844 shares.

DIAMOND HILL INVESTMENT GROUP, INC.

| | PAGE |
|--|------|
| <u>Part I: FINANCIAL INFORMATION</u> | |
| <u>Item 1. Consolidated Financial Statements</u> | 3 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 15 |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | 23 |
| <u>Item 4. Controls and Procedures</u> | 23 |
| <u>Part II: OTHER INFORMATION</u> | |
| <u>Item 1. Legal Proceedings</u> | 23 |
| <u>Item 1A. Risk Factors</u> | 23 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 23 |
| <u>Item 3. Defaults Upon Senior Securities</u> | 24 |
| <u>Item 4. (Removed and Reserved)</u> | 24 |
| <u>Item 5. Other Information</u> | 24 |
| <u>Item 6. Exhibits</u> | 25 |
| <u>Signatures</u> | 26 |
| <u>Exhibit 31.1</u> | |
| <u>Exhibit 31.2</u> | |
| <u>Exhibit 32.1</u> | |
| <u>EX-101 INSTANCE DOCUMENT</u> | |
| <u>EX-101 SCHEMA DOCUMENT</u> | |
| <u>EX-101 CALCULATION LINKBASE DOCUMENT</u> | |
| <u>EX-101 LABELS LINKBASE DOCUMENT</u> | |
| <u>EX-101 PRESENTATION LINKBASE DOCUMENT</u> | |

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

| | 6/30/2011 (Unaudited) | 12/31/2010 |
|---|--------------------------|---------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 14,136,691 | \$ 5,775,526 |
| Investment portfolio | 10,568,209 | 11,527,060 |
| Accounts receivable | 9,802,105 | 8,695,103 |
| Prepaid expenses | 722,610 | 787,033 |
| Furniture and equipment, net of depreciation, and other assets | 826,870 | 907,670 |
| Income tax receivable | 46,875 | |
| Deferred taxes | 1,304,275 | 873,474 |
| | | |
| Total assets | \$ 37,407,635 | \$ 28,565,866 |
| | | |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Liabilities | | |
| Accounts payable and accrued expenses | \$ 2,719,758 | \$ 4,101,079 |
| Accrued incentive compensation | 9,900,000 | 16,111,250 |
| Income tax payable | | 855,285 |
| | | |
| Total liabilities | 12,619,758 | 21,067,614 |
| | | |
| Commitments and contingencies | | |
| | | |
| Shareholders Equity | | |
| Common stock, no par value | | |
| 7,000,000 shares authorized; | | |
| 3,002,874 issued and outstanding at June 30, 2011; | | |
| 2,795,683 issued and outstanding at December 31, 2010 | 50,390,581 | 34,423,011 |
| Preferred stock, undesignated, 1,000,000 shares authorized and unissued | | |
| Deferred compensation | (13,176,298) | (7,137,729) |
| Retained earnings/(Accumulated deficit) | (12,426,406) | (19,787,030) |
| | | |
| Total shareholders equity | 24,787,877 | 7,498,252 |
| | | |
| Total liabilities and shareholders equity | \$ 37,407,635 | \$ 28,565,866 |
| | | |
| Book value per share | \$ 8.25 | \$ 2.68 |

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 June 30, | | Six Months Ended June 30, | |
|-------------------------------------|-----------------------------|---------------|---------------------------|---------------|
| | 2011 | 2010 | 2011 | 2010 |
| REVENUES: | | | | |
| Investment advisory | \$ 14,801,457 | \$ 11,933,346 | \$ 29,239,325 | \$ 23,413,871 |
| Mutual fund administration, net | 2,026,066 | 1,820,889 | 4,037,946 | 3,731,272 |
| Total revenue | 16,827,523 | 13,754,235 | 33,277,271 | 27,145,143 |
| OPERATING EXPENSES: | | | | |
| Compensation and related costs | 8,949,286 | 7,829,875 | 18,114,057 | 15,611,553 |
| General and administrative | 1,067,883 | 871,754 | 2,082,452 | 1,683,062 |
| Sales and marketing | 267,903 | 199,632 | 500,167 | 338,020 |
| Third party distribution | 230,312 | 258,880 | 480,981 | 517,655 |
| Mutual fund administration | 461,093 | 492,181 | 800,029 | 964,336 |
| Total operating expenses | 10,976,477 | 9,652,322 | 21,977,686 | 19,114,626 |
| NET OPERATING INCOME | 5,851,046 | 4,101,913 | 11,299,585 | 8,030,517 |
| Investment return | 90,362 | (1,183,703) | 461,143 | (938,786) |
| INCOME BEFORE TAXES | 5,941,408 | 2,918,210 | 11,760,728 | 7,091,731 |
| Income tax provision | (2,212,519) | (1,088,352) | (4,400,104) | (2,591,553) |
| NET INCOME | \$ 3,728,889 | \$ 1,829,858 | \$ 7,360,624 | \$ 4,500,178 |
| Earnings per share | | | | |
| Basic | \$ 1.26 | \$ 0.66 | \$ 2.54 | \$ 1.64 |
| Diluted | \$ 1.26 | \$ 0.66 | \$ 2.54 | \$ 1.64 |
| Weighted average shares outstanding | | | | |
| Basic | 2,967,002 | 2,773,533 | 2,902,788 | 2,746,455 |
| Diluted | 2,967,002 | 2,774,318 | 2,902,788 | 2,748,775 |

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)**

| | Six Months Ended June 30, | |
|---|---------------------------|---------------|
| | 2011 | 2010 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net Income | \$ 7,360,624 | \$ 4,500,178 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation on furniture and equipment | 166,371 | 162,213 |
| Stock-based compensation | 2,127,217 | 1,356,494 |
| (Increase) decrease in accounts receivable | (1,107,002) | 2,308,537 |
| Increase (decrease) in deferred income taxes | (442,141) | (792,887) |
| Investment gain/loss, net | (447,151) | 967,532 |
| Increase (decrease) in accrued liabilities | (130,587) | (1,015,057) |
| Other changes in assets and liabilities | (826,332) | (685,086) |
| Net cash provided by (used in) operating activities | 6,700,999 | 6,801,924 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of furniture and equipment | (85,571) | (52,870) |
| Cost of investments purchased and other portfolio activity | (926,998) | |
| Proceeds from sale of investments | 2,333,000 | |
| Net cash provided by (used in) investing activities | 1,320,431 | (52,870) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payment of taxes withheld on employee stock transactions | (139,707) | (11,360) |
| Proceeds from common stock issuance | 479,442 | 463,580 |
| Net cash provided by (used in) financing activities | 339,735 | 452,220 |
| CASH AND CASH EQUIVALENTS | | |
| Net change during the period | 8,361,165 | 7,201,274 |
| At beginning of period | 5,775,526 | 11,513,194 |
| At end of period | \$ 14,136,691 | \$ 18,714,468 |
| Supplemental cash flow information: | | |
| Interest paid | \$ | \$ |
| Income taxes paid | 5,733,000 | 4,142,700 |
| Supplemental disclosure of non-cash transactions: | | |
| Issuance of common stock as incentive compensation | 7,461,984 | 5,003,146 |

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

Table of Contents

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 that it provides to individual and institutional investors. The Company has four operating subsidiaries.

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

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

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

Note 2 **Significant Accounting Policies**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses for the periods. Actual results could differ from those estimates. 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, separate 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 funds.

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

Accounts receivable are recorded when they are due and are presented in the balance sheet, net of any allowance for doubtful accounts. Accounts receivable are written off when they are determined to be uncollectible. Any allowance for doubtful accounts is estimated based on the Company's historical losses, existing conditions in the industry, and the financial stability of those individuals or entities that owe the receivable. No allowance for doubtful accounts was deemed necessary at June 30, 2011 or December 31, 2010.

Valuation of Investment Portfolio

Investments held by the Company are valued based upon the definition of Level 1 inputs and Level 2 inputs. Level 1 inputs are defined as fair values which use quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are defined as quoted prices in markets that are not considered to be active for identical assets or liabilities, quoted prices in active markets for similar assets or liabilities and inputs other than quoted prices that are directly observable or indirectly through corroboration with observable market data. The following table summarizes the Company's investments valued based upon Level 1 and Level 2 inputs as of June 30, 2011 and December 31, 2010:

| | June 30, 2011 | December 31, 2010 |
|----------------|---------------|----------------------|
| Level 1 Inputs | \$ 1,321,634 | \$ 1,265,998 |
| Level 2 Inputs | 9,246,575 | 10,261,062 |

Level 1 investments are all registered investment companies (mutual funds). 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 return.

Limited Partnership Interests

DHCM is the managing member of Diamond Hill General Partner, LLC, the General Partner of Diamond Hill Investment Partners, LP (DHIP), Diamond Hill Investment Partners II, LP (DHIP II), Diamond Hill Research Partners, LP (DHRP), and Diamond Hill Research Partners International, LP (DHRPI) 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 the Partnerships' economic activities and the right to receive investment advisory and performance incentive fees that are significant to the Partnerships. The Partnerships are subject to investment company accounting and, as a result, they have not been consolidated in presenting the accompanying financial statements. 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 return.

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.

Table of Contents**Note 2 Significant Accounting Policies (Continued)****Limited Partnership Interests (Continued)**

Several board members, officers and employees of the Company invest in the Partnerships through Diamond Hill General Partner, LLC. These individuals receive no remuneration as a result of their personal investment in the Partnerships. The capital of Diamond Hill General Partner, LLC is not subject to a management fee or an incentive fee.

Furniture and Equipment

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

Revenue Recognition General

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

Revenue Recognition Performance Incentive Revenue

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

| | As Of June 30, | |
|--|----------------|----------------|
| | 2011 | 2010 |
| AUM Contractual Period Ends Quarterly | \$ 102,510,121 | \$ 99,737,213 |
| AUM Contractual Period Ends Annually | 127,418,326 | 170,047,709 |
| Total AUM Subject to Performance Incentive | \$ 229,928,447 | \$ 269,784,922 |

| | For The Three Months Ending June 30, | | For The Six Months Ending June 30, | |
|--|---|------|---------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Performance Incentive Fees Method 1 | \$ 187 | \$ | \$ 694 | \$ |
| Performance Incentive Fees Method 2 | \$ 722 | \$ | \$ 1,229 | \$ 56,488 |

Table of Contents

Note 2 Significant Accounting Policies (Continued)

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 compensates DHCM a fee, which is calculated using the following annual rates times the average daily net assets of each respective series and share class:

| | Prior to February 28, 2011 | After February 28, 2011 |
|---------------------|----------------------------------|-------------------------------|
| Class A and Class C | 0.30% | 0.26% |
| Class I | 0.19% | 0.24% |

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 the Funds pay to DHCM is reviewed annually by the Funds' board of trustees and specifically takes into account the contractual expenses that DHCM pays on behalf of the Funds. As a result, DHCM is not involved in the delivery or pricing of these services and bears no risk related to these services. Revenue has been recorded net of these Fund related expenses, in accordance with the appropriate accounting treatment for this agency relationship. In addition, DHCM finances the upfront commissions which are paid by the Fund's principal underwriter to brokers who sell Class C shares of the Funds. As financier, DHCM advances to the underwriter the commission amount to be paid to the selling broker at the time of sale. These advances are capitalized and amortized over 12 months to correspond with the repayments DHCM receives from the principal underwriter to recoup this commission advancement.

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.

Table of Contents

Note 2 Significant Accounting Policies (Continued)

Revenue Recognition – Mutual Fund Administration (Continued)

Mutual fund administration gross and net revenue are summarized below:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|--------------|---------------------------|--------------|
| | 2011 | 2010 | 2011 | 2010 |
| Mutual fund administration: | | | | |
| Administration revenue, gross | \$ 3,031,607 | \$ 2,756,455 | \$ 5,972,920 | \$ 5,562,566 |
| 12b-1/service fees and commission revenue received from fund clients | 1,876,633 | 2,092,674 | 3,773,805 | 4,319,661 |
| 12b-1/service fees and commission expense payments to third parties | (1,876,633) | (2,092,674) | (3,773,805) | (4,319,661) |
| Fund related expense | (1,014,851) | (948,869) | (1,957,895) | (1,876,074) |
| Revenue, net of fund related expenses | 2,016,756 | 1,807,586 | 4,015,025 | 3,686,492 |
| DHCM C-Share financing: | | | | |
| Broker commission advance repayments | 91,876 | 162,423 | 207,110 | 321,364 |
| Broker commission amortization | (82,566) | (149,120) | (184,189) | (276,584) |
| Financing activity, net | 9,310 | 13,303 | 22,921 | 44,780 |
| Mutual fund administration revenue, net | \$ 2,026,066 | \$ 1,820,889 | \$ 4,037,946 | \$ 3,731,272 |

Third Party Distribution Expense

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

Income Taxes

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

The Company has analyzed its tax positions taken on federal income tax returns for all open tax years (tax years ended December 31, 2007 through 2010) to determine any uncertainty in income taxes and has recognized no adjustment in the net asset or liability.

Earnings Per Share

Basic earnings per share (EPS) excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution of EPS that could occur if outstanding warrants were exercised. At June 30, 2011, there were no warrants outstanding.

Table of Contents**Note 3 Investment Portfolio**

As of June 30, 2011, the Company held investments worth \$10.6 million and an estimated cost basis of \$7.2 million. The following table summarizes the market value of these investments as of June 30, 2011 and December 31, 2010:

| | June 30, 2011 | December 31, 2010 |
|--|----------------------|----------------------|
| Diamond Hill Small Cap Fund | \$ 219,831 | \$ 211,301 |
| Diamond Hill Small-Mid Cap Fund | 230,703 | 217,915 |
| Diamond Hill Large Cap Fund | 223,049 | 210,413 |
| Diamond Hill Select Fund | 233,253 | 221,491 |
| Diamond Hill Long-Short Fund | 213,851 | 206,312 |
| Diamond Hill Strategic Income Fund | 200,947 | 198,566 |
| Diamond Hill Investment Partners, L.P. | 1,211,255 | 1,177,098 |
| Diamond Hill Investment Partners II, L.P. | 1,186,292 | 1,155,022 |
| Diamond Hill Research Partners, L.P. | 5,918,262 | 7,928,942 |
| Diamond Hill Research Partners International, L.P. | 930,766 | |
| Total Investment Portfolio | \$ 10,568,209 | \$ 11,527,060 |

DHCM is the managing member of the Diamond Hill General Partner LLC, which is the General Partner of the Partnerships. The underlying assets of the Partnerships are cash and marketable equity securities. Summary financial information, including the Company's carrying value and income from the Partnerships is as follows:

| | June 30, 2011 | As of December 31, 2010 |
|-------------------------------|----------------|-------------------------------|
| Total partnership assets | \$ 159,446,822 | \$ 173,007,238 |
| Total partnership liabilities | 29,959,618 | 32,855,190 |
| Net partnership assets | \$ 129,487,204 | \$ 140,152,048 |
| DHCM's portion of net assets | \$ 9,246,575 | \$ 10,261,062 |

| | For the Six Months Ended June 30, 2011 | For the Year Ended December 31, 2010 |
|------------------------------|---|---|
| Net partnership income | \$ 3,480,918 | \$ 4,486,719 |
| DHCM's portion of net income | \$ 393,515 | \$ 939,265 |

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

Note 4 Capital Stock**Common Shares**

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

Authorization of Preferred Shares

The Company's Articles of Incorporation authorize the issuance of 1,000,000 shares of blank check preferred shares with such designations, rights and preferences, as may be determined from time to time by the Company's Board of Directors. The Board of Directors is authorized, without shareholder approval, to issue preferred stock with dividend, liquidation, conversion, voting, or other rights, which could adversely affect the voting or other rights of the holders of

the Common Shares. There were no shares of preferred stock issued or outstanding at June 30, 2011 or December 31, 2010.

Table of ContentsNote 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 incentive 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. As of June 30, 2011, there were 499,625 Common Shares available for issuance 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.

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). With the approval of the 2011 Plan, there are no longer any Common Shares available for future issuance under the 2005 Plan. Outstanding grants under the 2005 Plan are unaffected and 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.

401(k) Plan

The Company sponsors a 401(k) plan under 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 three and six months ended June 30, 2011 and 2010:

| | June 30, 2011 | June 30, 2010 |
|--------------------|------------------|------------------|
| Three Months Ended | \$ 238,597 | \$ 215,711 |
| Six Months Ended | 479,442 | 426,992 |

Table of ContentsNote 5 Stock-Based Compensation (Continued)Stock Options and Warrants

There were no stock options outstanding during the periods presented in these financial statements. There were no warrants outstanding as of June 30, 2011 and 2010. Warrant transactions during the periods presented in these financial statements are summarized below:

| | Shares | Warrants Weighted Average Exercise Price |
|-------------------------------|--------|---|
| Outstanding December 31, 2009 | 6,000 | \$ 10.42 |
| Exercisable December 31, 2009 | 6,000 | \$ 10.42 |
| Granted | | |
| Expired / Forfeited | 4,000 | 10.00 |
| Exercised | 2,000 | 10.00 |
| Outstanding June 30, 2010 | | \$ |
| Exercisable June 30, 2010 | | \$ |

Note 6 Operating Leases

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 and six months ended June 30, 2011 and 2010:

| | June 30, 2011 | June 30, 2010 |
|--------------------|------------------|------------------|
| Three Months Ended | \$ 140,796 | \$ 138,848 |
| Six Months Ended | 287,021 | 283,005 |

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

| 2011 | 2012 | 2013 | 2014 | 2015 | Thereafter |
|------------|------------|------------|------------|------------|------------|
| \$ 212,000 | \$ 440,000 | \$ 417,000 | \$ 397,000 | \$ 401,000 | \$ 234,000 |

In addition to the above rent, the Company will also be responsible for normal operating expenses of the properties. Such operating expenses were approximately \$9.97 per square foot in 2010, on a combined basis, and are expected to be approximately \$9.60 per square foot in 2011.

Note 7 Income Taxes

The provision for income taxes for the three and six months ended June 30, 2011 and 2010 consists of federal, state and city income taxes. As of June 30, 2011, the Company and its subsidiaries had a capital loss carry forward of approximately \$1.9 million. The capital loss carry forward is available to offset capital gains in future years.

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

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|--------------|---------------------------|--------------|
| | 2011 | 2010 | 2011 | 2010 |
| Basic and Diluted net income | \$ 3,728,889 | \$ 1,829,858 | \$ 7,360,624 | \$ 4,500,178 |
| Weighted average number of outstanding shares | | | | |
| Basic | 2,967,002 | 2,773,533 | 2,902,788 | 2,746,455 |
| Diluted | 2,967,002 | 2,774,318 | 2,902,788 | 2,748,775 |
| Earnings per share | | | | |
| Basic | \$ 1.26 | \$ 0.66 | \$ 2.54 | \$ 1.64 |
| Diluted | \$ 1.26 | \$ 0.66 | \$ 2.54 | \$ 1.64 |

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 June 30, 2011 and December 31, 2010. The net capital balances, minimum net capital requirements, and ratio of aggregate indebtedness to net capital for BHIL are summarized below as of June 30, 2011 and December 31, 2010:

| | June 30, 2011 | December 31, 2010 |
|--|------------------|----------------------|
| Net Capital | \$ 244,296 | \$ 86,107 |
| Minimum Net Capital Requirement | 43,141 | 35,667 |
| Ratio of Aggregate Indebtedness to Net Capital | 2.65 to 1 | 8.79 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.

Table of Contents

DIAMOND HILL INVESTMENT GROUP, INC.

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, the Company 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, 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 identify forward-looking statements that are made as of the date thereof. While the Company believes that the assumptions underlying its forward-looking statements are reasonable, investors are cautioned that any of the assumptions could prove to be inaccurate and accordingly, the actual results and experiences of the Company could differ materially from the anticipated results or other expectations expressed by the Company in its forward-looking statements. Factors that could cause such actual results or experiences to differ from results discussed in the forward-looking statements include, but are not limited to: the adverse effect from a decline in the securities markets; a decline in the performance of the Company's products; changes in interest rates; a general or prolonged downturn in the economy; changes in government policy and regulation, including monetary policy; changes in the Company's ability to attract or retain key employees; unforeseen costs and other effects related to legal proceedings or investigations of governmental and self-regulatory organizations; and other risks identified from time-to-time in the Company's public documents on file with the SEC.

General

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

In this section, the Company discusses and analyzes the consolidated results of operations for the three and six month periods ending June 30, 2011 and 2010 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, 2010. However, in the opinion of management, all adjustments (consisting of only normal recurring accruals) which are necessary for a fair presentation of the financial statements have been included. The results of operations for the three and six month periods ended June 30, 2011 are not necessarily indicative of the results which may be expected for the entire fiscal year.

The Company's revenue is derived primarily from investment advisory and administration fees. 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 assets under management (AUM). Such fees are recognized in the period that the Company manages these assets. Performance incentive fees are generally 20% of the amount of client annual investment performance in excess of a specified hurdle. Because performance incentive fees are based primarily on the performance of client accounts, they can be volatile from period to period. The Company's primary expense is employee compensation and benefits.

Table of Contents**Assets Under Management**

As of June 30, 2011, AUM totaled \$9.2 billion, a 42% increase in comparison to June 30, 2010. Revenues are highly dependent on both the value and composition of AUM. The following tables show AUM by product and investment objective for the dates indicated and a roll-forward of the change in AUM for the six months ended June 30, 2011 and 2010:

| (in millions) | Assets Under Management by Product | | |
|--------------------------|---|-----------------|-----------------|
| | As of June 30, | | |
| | 2011 | 2010 | % Change |
| Mutual funds | \$ 4,385 | \$ 3,648 | 20% |
| Separate accounts | 3,533 | 2,505 | 41% |
| Sub-advised mutual funds | 1,073 | 133 | 707% |
| Private investment funds | 195 | 196 | -1% |
| Total AUM | \$ 9,186 | \$ 6,482 | 42% |

| (in millions) | Assets Under Management by Investment Objective | | |
|------------------|--|-----------------|-----------------|
| | As of June 30, | | |
| | 2011 | 2010 | % Change |
| Small | \$ 980 | \$ 735 | 33% |
| Small-Mid Cap | 318 | 149 | 113% |
| Large Cap | 5,029 | 2,870 | 75% |
| Select | 414 | 370 | 12% |
| Long-Short | 2,261 | 2,188 | 3% |
| Strategic Income | 184 | 170 | 8% |
| Total AUM | \$ 9,186 | \$ 6,482 | 42% |

| (in millions) | Change in Assets Under Management | |
|---|--|-----------------|
| | For the Six Months Ended June 30, | |
| | 2011 | 2010 |
| AUM at beginning of the period | \$ 8,623 | \$ 6,283 |
| Net cash inflows (outflows) | | |
| mutual funds | 2 | 440 |
| sub-advised mutual funds | 77 | (1) |
| separate accounts | 34 | 290 |
| private investment funds | (20) | (0) |
| | 93 | 729 |
| Net market appreciation (depreciation) and income | 470 | (530) |
| Increase during the period | 563 | 199 |
| AUM at end of the period | \$ 9,186 | \$ 6,482 |

Table of Contents**Consolidated Results of Operations**

The following is a discussion of the consolidated results of operations of the Company.

| (in thousands, except per share amounts) | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|---|-----------------------------|----------|----------|---------------------------|----------|----------|
| | 2011 | 2010 | % Change | 2011 | 2010 | % Change |
| Net operating income | \$ 5,851 | \$ 4,102 | 43% | \$ 11,300 | \$ 8,031 | 41% |
| Net operating income after tax ^(a) | \$ 3,672 | \$ 2,572 | 43% | \$ 7,072 | \$ 5,096 | 39% |
| Net income | \$ 3,729 | \$ 1,830 | 104% | \$ 7,361 | \$ 4,500 | 64% |
| Net operating income after tax per share ^(a) | | | | | | |
| Basic | \$ 1.24 | \$ 0.93 | 33% | \$ 2.44 | \$ 1.86 | 31% |
| Diluted | \$ 1.24 | \$ 0.93 | 33% | \$ 2.44 | \$ 1.85 | 32% |
| Net income per share | | | | | | |
| Basic | \$ 1.26 | \$ 0.66 | 91% | \$ 2.54 | \$ 1.64 | 55% |
| Diluted | \$ 1.26 | \$ 0.66 | 91% | \$ 2.54 | \$ 1.64 | 55% |
| Operating profit margin | 35% | 30% | NM | 34% | 30% | NM |

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

Three Months Ended June 30, 2011 compared with Three Months Ended June 30, 2010

The Company generated net income of \$3,728,889 (\$1.26 per diluted share) for the three months ended June 30, 2011, compared with net income of \$1,829,858 (\$0.66 per diluted share) for the three months ended June 30, 2010. While net income increased \$1.9 million, revenue for the period increased \$3.1 million and net investment return increased \$1.3 million offset by a \$1.3 million increase in operating expenses and a \$1.2 million increase in the income tax provision. Operating profit margin increased to 35% for second quarter 2011 from 30% for second quarter 2010. The Company expects that its operating margin will fluctuate from period to period based on various factors including revenues; investment results; employee performance; staffing levels; development of investment strategies, products, or channels; and industry comparisons.

Revenue

| (in thousands) | Three Months Ended June 30, | | |
|---------------------------------|-----------------------------|-----------|----------|
| | 2011 | 2010 | % Change |
| Investment advisory | \$ 14,801 | \$ 11,933 | 24% |
| Mutual fund administration, net | 2,026 | 1,821 | 11% |
| Total | \$ 16,827 | \$ 13,754 | 22% |

As a percent of total second quarter 2011 revenues, investment advisory fees accounted for 88% and mutual fund administration fees made up the remaining 12%. This compared to 87% and 13%, respectively, for second quarter 2010.

Investment Advisory Fees. Investment advisory fees increased by \$2.9 million, or 24%, from the quarter ended June 30, 2010 to the quarter ended June 30, 2011. Investment advisory fees are calculated as a percent of average net AUM at various levels depending on the investment product. The Company's average advisory fee rate for the three months ended June 30, 2011 was 0.63% compared to 0.70% for the three months ended June 30, 2010. The decrease

in the average advisory fee rate is due to an overall change in the composition of AUM where long-short strategies, which pay a higher advisory fee, made up 25% of total AUM as of June 30, 2011 compared to 34% of total AUM as of June 30, 2010 while long only strategies, which have a lower advisory fee, made up 59% of total AUM as of June 30, 2011 compared to 50% of total AUM as of June 30, 2010. The Company's average AUM during the quarter ended June 30, 2011 was \$9.3 billion compared to \$6.8 billion for the quarter ended June 30, 2010. Despite the 0.07% decrease in average advisory fee rate during second quarter 2011 compared to second quarter 2010, the fee rate was being charged on a greater asset base as the average AUM increased 38% from second quarter 2010 to second quarter 2011 resulting in an increase in the overall fees earned during the period. The Company anticipates the average advisory fee rate to continue to decrease throughout 2011 based upon the continued change in asset composition due to asset growth in lower fee strategies.

Table of Contents

Mutual Fund Administration Fees. Mutual fund administration fees increased \$205 thousand, or 11%, from the quarter ended June 30, 2010 to the quarter ended June 30, 2011. Mutual fund administration fees include administration fees received from Diamond Hill Funds, which are calculated as a percent of average mutual fund AUM, and all Beacon Hill fee revenue. The increase in the mutual fund administration fee is due to a 17% increase in average mutual fund AUM from \$3.8 billion for the quarter ended June 30, 2010 to \$4.4 billion for the quarter ended June 30, 2011 offset by a decrease in the overall blended net administration fee rate from 0.16% for the quarter ended June 30, 2010 to 0.15% for the quarter ended June 30, 2011.

Expenses

| (in thousands) | Three Months Ended | | % Change |
|--------------------------------|--------------------|----------|----------|
| | June 30, | | |
| | 2011 | 2010 | |
| Compensation and related costs | \$ 8,949 | \$ 7,830 | 14% |
| General and administrative | 1,068 | 872 | 22% |
| Sales and marketing | 268 | 199 | 35% |
| Third party distribution | 230 | 259 | -11% |
| Mutual fund administration | 461 | 492 | -6% |
| Total | \$ 10,976 | \$ 9,652 | 14% |

Compensation and Related Costs. Employee compensation and benefits increased \$1.1 million, or 14%, during the three months ended June 30, 2011 compared to the same period a year ago primarily due to a \$780 thousand increase in restricted stock expense related to an overall increase in the total amount of long-term equity awards outstanding in 2011 compared to 2010 and a \$247 thousand increase in base salaries and related benefits due an increase in employee headcount, while incentive compensation remained flat quarter-over-quarter.

The increase in restricted stock expense was primarily due to a 100,000 share five year cliff vesting stock grant issued per the executed Amended and Restated Employment Agreement between the Company and its Chief Executive Officer as announced in the Form 8-K filed with the SEC on March 24, 2011. This increase in restricted stock expense served to decrease the amount that would have otherwise been recognized as incentive compensation during the period.

General and Administrative. General and administrative expenses increased by \$196 thousand, or 22%, period over period. This increase is primarily due to additional research expenses and systems related expenses to support the Company's investment team and an increase in information technology related expenses.

Sales and Marketing. Sales and marketing expenses increased by \$69 thousand, or 35%. The increase was primarily due to an increase in travel and other expenses related to business development and retention efforts during second quarter 2011.

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

Mutual Fund Administration. Mutual fund administration expense decreased by \$31 thousand, or 6%, period over period. The majority of mutual fund administration fees are variable based on the amount of mutual fund AUM. Despite an overall increase in mutual fund AUM of 20% as of June 30, 2011 compared to June 30, 2010, the decrease in mutual fund administration expenses is primarily due to a third party service provider fee reduction effective October 1, 2010.

Table of Contents**Six Months Ended June 30, 2011 compared with Six Months Ended June 30, 2010**

The Company generated net income of \$7,360,624 (\$2.54 per diluted share) for the six months ended June 30, 2011, compared with net income of \$4,500,178 (\$1.64 per diluted share) for the six months ended June 30, 2010. While net income increased \$2.9 million, revenue for the period increased \$6.1 million and net investment return increased \$1.4 million offset by a \$2.9 million increase in operating expenses and a \$1.8 million increase in the income tax provision from the six months ended June 30, 2010 to the six months ended June 30, 2011. Operating profit margin increased to 34% for the six months ended June 30, 2011 from 30% for the six months ended June 30, 2010. The Company expects that its operating margin will fluctuate from period to period based on various factors including revenues; investment results; employee performance; staffing levels; development of investment strategies, products, or channels; and industry comparisons.

Revenue

| (in thousands) | Six Months Ended June 30, | | % Change |
|---------------------------------|------------------------------|-----------|----------|
| | 2011 | 2010 | |
| Investment advisory | \$ 29,239 | \$ 23,414 | 25% |
| Mutual fund administration, net | 4,038 | 3,731 | 8% |
| Total | \$ 33,277 | \$ 27,145 | 23% |

As a percent of 2011 year to date revenues, investment advisory fees accounted for 88% and mutual fund administration fees accounted for the remaining 12% compared to the 2010 period where investment advisory fees accounted for 86% and mutual fund administration fees accounted for the remaining 14% of revenues.

Investment Advisory Fees. Investment advisory fees increased by \$5.8 million, or 25%, for the six months ended June 30, 2011 compared to the six months ended June 30, 2010. Investment advisory fees are calculated as a percent of average net AUM at various levels depending on the investment product. The Company's average advisory fee rate for the six months ended June 30, 2011 was 0.64% compared to 0.71% for the six months ended June 30, 2010. The decrease in the average advisory fee rate is due to an overall change in the composition of AUM where long-short strategies, which pay a higher advisory fee, made up 25% of total AUM as of June 30, 2011 compared to 34% of total AUM as of June 30, 2010 while long only strategies, which have a lower advisory fee, made up 59% of total AUM as of June 30, 2011 compared to 50% of total AUM as of June 30, 2010. Despite the 0.07% decrease in average advisory fee rate period over period, the fee rate was being charged on a greater asset base as the average AUM increased 39% from the six months ended June 30, 2010 to the six months ended June 30, 2011 resulting in an increase in the overall fees earned during the period. The Company anticipates the average advisory fee rate to continue to decrease throughout 2011 based upon the continued change in asset composition due to asset growth in lower fee strategies.

Mutual Fund Administration Fees. Mutual fund administration revenues increased by \$307 thousand for the six months ended June 30, 2011 compared to the six months ended June 30, 2010. Mutual fund administration fees include administration fees received from Diamond Hill Funds, which are calculated as a percent of average mutual fund AUM, and all Beacon Hill fee revenue. The increase in the mutual fund administration fee is due to a 19% increase in average mutual fund AUM from \$3.7 billion for the six months ended June 30, 2010 to \$4.4 billion for the six months ended June 30, 2011 offset by a decrease in the overall blended net administration fee rate from 0.17% for the six months ended June 30, 2010 to 0.15% for the six months ended June 30, 2011.

Table of Contents**Expenses**

| (in thousands) | Six Months Ended | | % Change |
|--------------------------------|------------------|-----------|----------|
| | June 30, | | |
| | 2011 | 2010 | |
| Compensation and related costs | \$ 18,114 | \$ 15,612 | 16% |
| General and administrative | 2,083 | 1,683 | 24% |
| Sales and marketing | 500 | 338 | 48% |
| Third party distribution | 481 | 518 | -7% |
| Mutual fund administration | 800 | 964 | -17% |
| | | | |
| Total | \$ 21,978 | \$ 19,115 | 15% |

Compensation and Related Costs. Employee compensation and benefits increased \$2.5 million, or 16%, during the six months ended June 30, 2011 compared to the same period a year ago, primarily due to an increase of \$1.5 million in incentive compensation during the period consistent with a 42% increase in AUM and the associated increase in operating income. Further contributors to the overall increase in compensation expense were restricted stock expense, which increased by \$733 thousand due to an overall increase in the total amount of long-term equity awards outstanding in 2011 compared to 2010, and base salaries and related benefits, which increased by \$233 thousand due to an increase in employee headcount.

The increase in restricted stock expense was primarily due to a 100,000 share five year cliff vesting stock grant issued per the executed Amended and Restated Employment Agreement between the Company and its Chief Executive Officer as announced in the Form 8-K filed with the SEC on March 24, 2011. This increase in restricted stock expense served to decrease the amount that would have otherwise been recognized as incentive compensation during the period.

General and Administrative. General and administrative expenses increased by \$400 thousand, or 24%, period over period. This increase is primarily due to additional research expenses and systems related expenses to support the Company's investment team, the implementation of a new trading system during second quarter 2010, and an increase in information technology related expenses and corporate legal costs.

Sales and Marketing. Sales and marketing expenses increased by \$162 thousand, or 48%, period over period. The increase was primarily due to an increase in travel and other expenses related to business development and retention efforts during 2011.

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

Mutual Fund Administration. Mutual fund administration expense decreased by \$164 thousand, or 17%, period over period. The majority of mutual fund administration fees are variable based on the amount of mutual fund AUM. Despite an overall increase in mutual fund AUM of 20%, as of June 30, 2011 compared to June 30, 2010, the decrease in mutual fund administration expenses is primarily due to a third party service provider fee reduction effective October 1, 2010.

Table of Contents**Beacon Hill Fund Services**

Beacon Hill is currently staffed with 13 full-time employees, up from 12 at June 30, 2010, and provides compliance, treasurer, and other fund administration services to mutual fund clients and their investment advisers. In addition, through its registered broker/dealer, Beacon Hill also serves as the underwriter for a number of mutual funds. The following is a summary of Beacon Hill's performance for the three and six months ended June 30, 2011 compared to the three and six months ended June 30, 2010, excluding 12b-1/service fees and commission revenue and expenses, which net to zero:

| (in thousands) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|----------------------|--------------------------------|----------|------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Revenue ¹ | \$ 450 | \$ 402 | \$ 939 | \$ 783 |
| Expenses | 584 | 607 | 1,209 | 1,217 |
| Net loss | \$ (134) | \$ (205) | \$ (270) | \$ (434) |

¹ Beacon Hill's revenue for the three months ended June 30, 2011 and 2010 includes \$129 thousand and \$131 thousand, respectively, of inter-company revenue earned from services provided to DHCM. Beacon Hill's revenue for the six months ended June 30, 2011 and 2010 includes \$260 thousand and \$241 thousand, respectively, of inter-company revenue earned from services provided to DHCM. These amounts have been eliminated from the Consolidated Statements of Income.

Liquidity and Capital Resources

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

As of June 30, 2011, the Company had working capital of approximately \$21.9 million compared to \$4.9 million at December 31, 2010. Working capital includes cash, securities owned and accounts receivable, net of all liabilities. The Company has no debt and its available working capital is expected to be sufficient to cover current expenses. The Company does not expect any material capital expenditures during 2011.

During the third quarter of 2007 the Board of Directors authorized management to repurchase up to 350,000 shares of the Company's common stock. Under the program, the Company has repurchased a total 16,105 shares since third quarter 2007. No shares were repurchased during the six months ended June 30, 2011.

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

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

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

performance measures of other companies.

Table of Contents

| (in thousands, except per share data) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|----------|---------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Net operating income, GAAP basis | \$ 5,851 | \$ 4,102 | \$ 11,300 | \$ 8,031 |
| Non-GAAP adjustments: | | | | |
| Tax provision excluding impact of investment return | 2,179 | 1,530 | 4,228 | 2,935 |
| Net operating income after tax, non-GAAP basis | 3,672 | 2,572 | 7,072 | 5,096 |
| Net operating income after tax per basic share, non-GAAP basis | \$ 1.24 | \$ 0.93 | \$ 2.44 | \$ 1.86 |
| Net operating income after tax per diluted share, non-GAAP basis | \$ 1.24 | \$ 0.93 | \$ 2.44 | \$ 1.85 |
| Basic weighted average shares outstanding, GAAP basis | 2,967 | 2,774 | 2,903 | 2,746 |
| Diluted weighted average shares outstanding, GAAP basis | 2,967 | 2,774 | 2,903 | 2,749 |

The tax provision excluding impact of investment return is calculated by applying the tax rate from the actual tax provision to net operating income.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements. It does not have any obligation under a guarantee contract, or a retained or contingent interest in assets or similar arrangement that serves as credit, liquidity or market risk support for such assets, or any other obligation, including a contingent obligation, under a contract that would be accounted for as a derivative instrument or arising out of a variable interest.

Critical Accounting Policies and Estimates

There have been no material changes to the Critical Accounting Policies and Estimates provided in Item 7 of the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

Table of Contents

DIAMOND HILL INVESTMENT GROUP, INC.

ITEM 3: Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in the information provided in Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

ITEM 4: Controls and Procedures

Management, including the Chief Executive Officer and the Chief Financial Officer, has conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934) as of the end of the period covered by this quarterly report (the Evaluation Date). Based on such evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and to ensure that the information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

There have been no changes in the Company's internal control over financial reporting during the six-month period ending June 30, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II: OTHER INFORMATION**ITEM 1: Legal Proceedings**

From time to time, the Company is party to ordinary routine litigation that is incidental to its business. The Company believes these claims will not have a material adverse effect on its financial condition, liquidity or results of operations.

ITEM 1A: Risk Factors

There has been no material change to the information provided in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

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

The Company did not purchase any shares of its common stock during the six months ended June 30, 2011. The following table sets forth information regarding the Company's repurchase program of its common stock during the second quarter of fiscal year 2011:

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as part of a Publicly Announced Plans or Programs | Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (1) |
|--------------------------------------|--|---------------------------------------|---|--|
| April 1, 2011 through April 30, 2011 | | | | 333,895 |
| May 1, 2011 through May 31, 2011 | | | | 333,895 |
| June 1, 2011 through June 30, 2011 | | | | 333,895 |

(1)

- The Company's current share repurchase program was announced on August 9, 2007. The board of directors authorized management to repurchase up to 350,000 shares of its common stock in the open market and in private transactions in accordance with applicable securities laws. The Company's stock repurchase program is not subject to an expiration date.

Table of Contents

ITEM 3: Defaults Upon Senior Securities

None

ITEM 4: (Removed and Reserved).

ITEM 5: Other Information

None

Table of Contents

ITEM 6: Exhibits

- 3.1 Amended and Restated Articles of Incorporation of the Company. (Incorporated by reference from Form 8-K Current Report for the event on May 2, 2002 filed with the SEC on May 7, 2002; File No. 000-24498.)
- 3.2 Code of Regulations of the Company. (Incorporated by reference from Form 8-K Current Report for the event on May 2, 2002 filed with the SEC on May 7, 2002; File No. 000-24498.)
- 31.1 Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a).
- 31.2 Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a).
- 32.1 Section 1350 Certifications.
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

Table of Contents

DIAMOND HILL INVESTMENT GROUP, INC.

SIGNATURES

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

DIAMOND HILL INVESTMENT GROUP, INC.

| Date | Title | Signature |
|---------------|---|--------------------------------------|
| July 29, 2011 | President, Chief Executive Officer, and a Director | /s/ R. H. Dillon R. H. Dillon |
| July 29, 2011 | Chief Financial Officer, Treasurer, and Secretary | /s/ James F. Laird James F. Laird |