

DIAMOND HILL INVESTMENT GROUP INC

Form 10-Q

April 29, 2011

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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, 2011

Commission file number 000-24498

DIAMOND HILL INVESTMENT GROUP, INC.

(Exact name of registrant as specified in its charter)

Ohio

(State of incorporation)

65-0190407

(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 April 27, 2011, is 2,901,769 shares.

DIAMOND HILL INVESTMENT GROUP, INC.

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	3/31/2011 (Unaudited)	12/31/2010
ASSETS		
Cash and cash equivalents	\$ 5,212,306	\$ 5,775,526
Investment portfolio	10,483,953	11,527,060
Accounts receivable	9,565,273	8,695,103
Prepaid expenses	811,488	787,033
Furniture and equipment, net of depreciation, and other assets	831,434	907,670
Deferred taxes	907,585	873,474
Total assets	\$ 27,812,039	\$ 28,565,866
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities		
Accounts payable and accrued expenses	\$ 2,470,176	\$ 4,101,079
Accrued incentive compensation	5,400,000	16,111,250
Income tax payable	414,079	855,285
Total liabilities	8,284,255	21,067,614
Commitments and contingencies		
Shareholders Equity		
Common stock, no par value 7,000,000 shares authorized; 2,899,282 issued and outstanding at March 31, 2011; 2,795,683 issued and outstanding at December 31, 2010	42,112,791	34,423,011
Preferred stock, undesignated, 1,000,000 shares authorized and unissued	(6,429,711)	(7,137,729)
Deferred compensation	(16,155,296)	(19,787,030)
Retained earnings/(Accumulated deficit)		
Total shareholders equity	19,527,784	7,498,252
Total liabilities and shareholders equity	\$ 27,812,039	\$ 28,565,866
Book value per share	\$ 6.74	\$ 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 March 31,	
	2011	2010
REVENUES:		
Investment advisory	\$ 14,437,868	\$ 11,480,525
Mutual fund administration, net	2,011,880	1,910,383
Total revenue	16,449,748	13,390,908
OPERATING EXPENSES:		
Compensation and related costs	9,164,771	7,781,678
General and administrative	1,014,569	811,309
Sales and marketing	232,264	138,388
Third party distribution	250,669	258,775
Mutual fund administration	338,937	472,154
Total operating expenses	11,001,210	9,462,304
NET OPERATING INCOME	5,448,538	3,928,604
Investment return	370,781	244,917
INCOME BEFORE TAXES	5,819,319	4,173,521
Income tax provision	(2,187,585)	(1,503,201)
NET INCOME	\$ 3,631,734	\$ 2,670,320
Earnings per share		
Basic	\$ 1.28	\$ 0.98
Diluted	\$ 1.28	\$ 0.98
Weighted average shares outstanding		
Basic	2,837,860	2,719,075
Diluted	2,837,860	2,720,804

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,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$ 3,631,734	\$ 2,670,320
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation on furniture and equipment	82,496	79,557
Amortization of deferred compensation	527,063	583,744
(Increase) decrease in accounts receivable	(870,170)	2,139,984
Increase (decrease) in deferred income taxes	(34,111)	(94,633)
Noncash director fee expense	199,827	164,827
Investment gain/loss, net	(364,386)	(231,863)
Decrease in accrued liabilities	(4,880,169)	(5,751,261)
Other changes in assets and liabilities	(458,759)	(337,376)
Net cash used in operating activities	(2,166,475)	(776,701)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of furniture and equipment	(6,260)	(12,319)
Cost of investments purchased and other portfolio activity	(925,507)	
Proceeds from sale of investments	2,333,000	
Net cash provided by (used in) investing activities	1,401,233	(12,319)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of taxes withheld on employee stock transactions	(38,824)	
Proceeds from common stock issuance	240,846	240,773
Net cash provided by financing activities	202,022	240,773
CASH AND CASH EQUIVALENTS		
Net change during the period	(563,220)	(548,247)
At beginning of period	5,775,526	11,513,194
At end of period	\$ 5,212,306	\$ 10,964,947
Cash paid during the period for:		
Interest	\$	\$
Income taxes	2,656,000	1,951,700
Noncash transactions during the period for:		
Common stock issued as incentive compensation	7,461,984	5,003,146

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 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.

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Note 2 Significant Accounting Policies (Continued)

Accounts Receivable

Accounts receivable are recorded when they are due and are presented in the balance sheet, net of any allowance for doubtful accounts. Accounts receivable are written off when they are determined to be uncollectible. Any allowance for doubtful accounts is estimated based on the Company's historical losses, existing conditions in the industry, and the financial stability of those individuals or entities that owe the receivable. No allowance for doubtful accounts was deemed necessary at March 31, 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. At March 31, 2011, \$1,320,690 and \$9,163,263 in Company investments are valued based upon Level 1 and Level 2 inputs, respectively. At December 31, 2010, \$1,265,998 and \$10,261,062 in Company investments are valued based upon Level 1 and Level 2 inputs, respectively. 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.

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

Table of ContentsNote 2 **Significant Accounting Policies (Continued)****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 March 31,	
	2011	2010
AUM – Contractual Period Ends Quarterly	\$ 110,628,628	\$ 108,323,321
AUM – Contractual Period Ends Annually	138,280,045	184,966,484
Total AUM Subject to Performance Incentive	\$ 248,908,673	\$ 293,289,805

	For The Three Months Ending March 31,	
	2011	2010
Performance Incentive Fees – Method 1	\$ 507	\$
Performance Incentive Fees – Method 2	\$ 507	\$ 105,039

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 at an annual rate of 0.30% for Class A and Class C shares and 0.19% for Class I shares times each series' average daily net assets. Effective February 28, 2011, the fee for administrative services was decreased from 0.30% to 0.26% for Class A and Class C shares and was increased from 0.19% to 0.24% for Class I shares. 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, 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

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Note 2 Significant Accounting Policies (Continued)

Revenue Recognition – Mutual Fund Administration (Continued)

the Funds pay to DHCM is reviewed annually by the Funds' board of trustees and specifically takes into account the contractual expenses that DHCM pays on behalf of the Funds. As a result, DHCM is not involved in the delivery or pricing of these services and bears no risk related to these services. Revenue has been recorded net of these Fund related expenses, as it is the appropriate accounting treatment for this agency relationship. In addition, DHCM finances the 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, as it is the appropriate accounting treatment for this agency relationship.

Mutual fund administration gross and net revenue are summarized below:

	Three Months Ended March 31,	
	2011	2010
Mutual fund administration:		
Administration revenue, gross	\$ 2,941,314	\$ 2,806,111
12b-1/service fees and commission revenue received from fund clients	1,897,172	2,226,988
12b-1/service fees and commission expense payments to third parties	(1,897,172)	(2,226,988)
Fund related expense	(943,045)	(927,205)
Revenue, net of fund related expenses	1,998,269	1,878,906
DHCM C-Share financing:		
Broker commission advance repayments	115,234	158,941
Broker commission amortization	(101,623)	(127,464)
Financing activity, net	13,611	31,477
Mutual fund administration revenue, net	\$ 2,011,880	\$ 1,910,383

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.

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

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 March 31, 2011, there were no warrants outstanding.

Note 3 **Investment Portfolio**

As of March 31, 2011, the Company held investments worth \$10.5 million and an estimated cost basis of \$7.1 million. The following table summarizes the market value of these investments as of March 31, 2011 and December 31, 2010:

	March 31, 2011	December 31, 2010
Diamond Hill Small Cap Fund	\$ 221,050	\$ 211,301
Diamond Hill Small-Mid Cap Fund	231,048	217,915
Diamond Hill Large Cap Fund	221,629	210,413
Diamond Hill Select Fund	231,034	221,491
Diamond Hill Long-Short Fund	214,981	206,312
Diamond Hill Strategic Income Fund	200,948	198,566
Diamond Hill Investment Partners, L.P.	1,200,183	1,177,098
Diamond Hill Investment Partners II, L.P.	1,176,350	1,155,022
Diamond Hill Research Partners, L.P.	5,856,856	7,928,942
Diamond Hill Research Partners International, L.P.	929,874	
Total Investment Portfolio	\$ 10,483,953	\$ 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:

	March 31, 2011	As of December 31, 2010
Total partnership assets	\$ 166,337,065	\$ 173,007,238
Total partnership liabilities	28,913,339	32,855,190
Net partnership assets	137,423,726	140,152,048
DHCM's portion of net assets	9,163,263	10,261,062
	For the Three Months Ended	For the Year Ended December 31,
	March 31, 2011	2010
Net partnership income	2,117,254	4,486,719
DHCM's portion of net income	310,200	939,265

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Note 3 Investment Portfolio (Continued)

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 March 31, 2011 or December 31, 2010.

Note 5 Stock-Based Compensation

Equity Incentive Plans

2005 Employee and Director Equity Incentive Plan

At the Company's annual shareholder meeting on May 12, 2005, shareholders approved the 2005 Employee and Director Equity Incentive Plan (2005 Plan). The 2005 Plan is intended to facilitate the Company's ability to attract and retain staff, provide additional incentive to employees, directors and consultants, and to promote the success of the Company's business. The 2005 Plan authorizes the issuance of Common Shares of the Company in various forms of stock or option grants. As of March 31, 2011, there were 191,564 shares available for issuance under the 2005 Plan. The 2005 Plan provides that the Board of Directors, or a committee appointed by the Board, may grant awards and otherwise administer the 2005 Plan. Restricted stock grants issued under the 2005 Plan, which vest over time, are recorded as deferred compensation in the equity section of the balance sheet on 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. For the three months ended March 31, 2011 and 2010, expenses attributable to the plan were \$240,847 and \$218,273, respectively.

Stock Options and Warrants

There were no stock options outstanding during the periods presented in these financials. There are no warrants outstanding as of March 31, 2011. Warrant transactions during the periods presented in these financials are summarized below:

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

	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	2,000		11.25
Exercised	2,000		11.25
Outstanding March 31, 2010	2,000	\$	8.75
Exercisable March 31, 2010	2,000	\$	8.75

During second quarter 2010, the remaining 2,000 warrants outstanding and exercisable expired unexercised.

Note 6 Operating Leases

The Company leases approximately 21,200 square feet of office space at two locations. Total lease and operating expenses for the three months ended March 31, 2011 and 2010 were \$146,372 and \$144,157 respectively. The approximate future minimum lease payments under the operating leases are as follows:

2011	2012	2013	2014	2015	Thereafter
\$253,000	\$ 348,000	\$ 356,000	\$ 358,000	\$ 361,000	\$ 210,000

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 \$9.94 per square foot in 2011.

Note 7 Income Taxes

The provision for income taxes for the three months ended March 31, 2011 and 2010 consists of federal, state and city income taxes. As of March 31, 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 March 31,	
	2011	2010
Basic and Diluted net income	\$ 3,631,734	\$ 2,670,320
Weighted average number of outstanding shares		
Basic	2,837,860	2,719,075
Diluted	2,837,860	2,720,804
Earnings per share		
Basic	\$ 1.28	\$ 0.98
Diluted	\$ 1.28	\$ 0.98

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 exceeds its minimum net capital requirement at March 31, 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 March 31, 2011 and December 31, 2010:

	March 31,	December 31,
	2011	2010
Net Capital	\$ 213,267	\$ 86,107
Minimum Net Capital Requirement	53,140	35,667
Ratio of Aggregate Indebtedness to Net Capital	3.74 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.

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DIAMOND HILL INVESTMENT GROUP, INC.

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

Forward-looking Statements

Throughout this 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 month period ending March 31, 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 month period ended March 31, 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 March 31, 2011, AUM totaled \$9.3 billion, a 35% increase in comparison to March 31, 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 three months ended March 31, 2011 and 2010:

(in millions)	2011	2010	% Change
Mutual funds	\$ 4,390	\$ 3,816	15%
Separate accounts	3,631	2,691	35%
Sub-advised mutual funds	1,021	153	567%
Private investment funds	208	216	-4%
Total AUM	\$ 9,250	\$ 6,876	35%

(in millions)	2011	2010	% Change
Small	\$ 1,006	\$ 701	44%
Small-Mid Cap	317	162	96%
Large Cap	5,095	3,038	68%
Select	390	423	-8%
Long-Short	2,263	2,382	-5%
Strategic Income	179	170	5%
Total AUM	\$ 9,250	\$ 6,876	35%

(in millions)	2011	2010
AUM at beginning of the period	\$ 8,623	\$ 6,283
Net cash inflows (outflows)		
mutual funds	3	254
sub-advised mutual funds	36	1
separate accounts	161	152
private investment funds	(6)	(0)
	194	407
Net market appreciation and income	433	186
Increase during the period	627	593
AUM at end of the period	\$ 9,250	\$ 6,876

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 March 31,		
	2011	2010	% Change
Net operating income	\$ 5,449	\$ 3,929	39%
Net operating income after tax ^(a)	\$ 3,401	\$ 2,514	35%
Net income	\$ 3,632	\$ 2,670	36%
Net operating income after tax per share ^(a)			
Basic	\$ 1.20	\$ 0.92	30%
Diluted	\$ 1.20	\$ 0.92	30%
Net income per share			
Basic	\$ 1.28	\$ 0.98	31%
Diluted	\$ 1.28	\$ 0.98	31%
Operating profit margin	33%	29%	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 18 of this report.

Three Months Ended March 31, 2011 compared with Three Months Ended March 31, 2010

The Company generated net income of \$3,631,734 (\$1.28 per diluted share) for the three months ended March 31, 2011, compared with net income of \$2,670,320 (\$0.98 per diluted share) for the three months ended March 31, 2010. While net income experienced an increase of \$960 thousand, revenue for the period increased \$3.1 million offset by a \$1.5 million increase in operating expenses and a \$680 thousand increase in the income tax provision. Operating profit margin increased to 33% for first quarter 2011 from 29% for first 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		
	March 31,		% Change
	2011	2010	
Investment advisory	\$ 14,438	\$ 11,481	26%
Mutual fund administration, net	2,012	1,910	5%
Total	\$ 16,450	\$ 13,391	23%

As a percent of total first quarter 2011 revenues, investment advisory fees accounted for 88% and mutual fund administration fees made up the remaining 12%. This compared to 86% and 14%, respectively, for first quarter 2010.

Investment Advisory Fees. Investment advisory fees increased by \$3.0 million, or 26%, from the quarter ended March 31, 2010 to the quarter ended March 31, 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 March 31, 2011 was 0.64% compared to 0.71% for the three months ended March 31, 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 24% of total AUM as of March 31, 2011 compared to 35% of

total AUM as of March 31, 2010 while long only strategies, which have a lower advisory fee, made up 59% of total AUM as of March 31, 2011 compared to only 50% of total AUM as of March 31, 2010. The Company's average AUM during the quarter ended March 31, 2011 was \$9.0 billion compared to \$6.5 billion for the quarter ended March 31, 2010. Despite the 0.07% decrease in average advisory fee rate during first quarter 2011 compared to first quarter 2010, the fee rate was being charged on a greater asset base as the average AUM increased 39% from first quarter 2010 to first 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.

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Mutual Fund Administration Fees. Mutual fund administration fees increased \$102 thousand, or 5%, from the quarter ended March 31, 2010 to the quarter ended March 31, 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 19% increase in average mutual fund AUM from \$3.6 billion as of March 31, 2010 to \$4.3 billion as of March 31, 2011 offset by a decrease in the overall blended net administration fee rate from 0.18% for the quarter ended March 31, 2010 to 0.15% for the quarter ended March 31, 2011.

Expenses

(in thousands)	Three Months Ended March 31,		% Change
	2011	2010	
Compensation and related costs	\$ 9,165	\$ 7,782	18%
General and administrative	1,014	811	25%
Sales and marketing	232	138	68%
Third party distribution	251	259	-3%
Mutual fund administration	339	472	-28%
Total	\$ 11,001	\$ 9,462	16%

Compensation and Related Costs. Employee compensation and benefits increased \$1.4 million, or 18%, during the three months ended March 31, 2011 compared to the same period a year ago, primarily due to a \$1.4 million increase in incentive compensation during the period consistent with an increase in AUM and the associated increase in operating income offset by \$20 thousand in timing differences of non-incentive based compensation.

General and Administrative. General and administrative expenses increased by \$203 thousand, or 25%, period over period. This increase is primarily due to additional research expenses to support the Company's investment team, implementation of a new trading system during the second quarter of 2010 and an increase in information technology related expenses.

Sales and Marketing. Sales and marketing expenses increased by \$94 thousand, or 68%. The increase was primarily due to an increase in travel and other expenses related to business development and retention efforts during first 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 \$133 thousand, or 28%, 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 15% as of March 31, 2011 compared to March 31, 2010, the decrease in mutual fund administration expenses is primarily due to a third party service provider fee reduction related to bringing certain administration activities in-house.

Table of Contents**Beacon Hill Fund Services**

Beacon Hill is currently staffed with 13 full-time equivalent employees, up from 12 at March 31, 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 months ended March 31, 2011 compared to the three months ended March 31, 2010, excluding 12b-1/service fees and commission revenue and expenses, which net to zero:

(in thousands)	Three Months Ended	
	March 31,	
	2011	2010
Revenue ¹	\$ 489	\$ 382
Expenses	625	610
Net loss	\$ (136)	\$ (228)

¹ Beacon Hill's revenue for the three months ended March 31, 2011 and 2010 includes \$131 thousand and \$111 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 March 31, 2011, the Company had working capital of approximately \$17.0 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 three months ended March 31, 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.

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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.

(in thousands, except per share data)	Three Months Ended March	
	2011	2010
Net Operating Income, GAAP basis	\$ 5,449	\$ 3,929
Non-GAAP Adjustments:		
Tax Provision excluding impact of Investment Return	2,048	1,415
Net operating income after tax, non-GAAP basis	3,401	2,514
Net operating income after tax per basic share, non-GAAP basis	\$ 1.20	\$ 0.92
Net operating income after tax per diluted share, non-GAAP basis	\$ 1.20	\$ 0.92
Basic weighted average shares outstanding, GAAP basis	2,838	2,719
Diluted weighted average shares outstanding, GAAP basis	2,838	2,721

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.

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DIAMOND HILL INVESTMENT GROUP, INC.

ITEM 3: Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in the information provided in Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 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 three-month period ending March 31, 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 three months ended March 31, 2011. The following table sets forth information regarding the Company's repurchase program of its common stock during the first 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)
January 1, 2011 through January 31, 2011				333,895
February 1, 2011 through February 28, 2011				333,895
				333,895

March 1, 2011 through
March 31, 2011

- (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.

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ITEM 3: Defaults Upon Senior Securities

None

ITEM 4: (Removed and Reserved).

ITEM 5: Other Information

None

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DIAMOND HILL INVESTMENT GROUP, INC.

ITEM 6: Exhibits

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

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DIAMOND HILL INVESTMENT GROUP, INC.

SIGNATURES

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

DIAMOND HILL INVESTMENT GROUP, INC.

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