

DIAMOND HILL INVESTMENT GROUP INC

Form 10-Q

October 28, 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 September 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 October 26, 2011, is 2,996,287 shares.

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

	9/30/2011 (Unaudited)	12/31/2010
<b>ASSETS</b>		
Cash and cash equivalents	\$ 22,920,367	\$ 5,775,526
Investment portfolio	9,252,870	11,527,060
Accounts receivable	8,608,934	8,695,103
Prepaid expenses	895,960	787,033
Furniture and equipment, net of depreciation, and other assets	887,451	907,670
Income tax receivable	301,007	
Deferred taxes	2,065,672	873,474
Total assets	\$ 44,932,261	\$ 28,565,866
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Accounts payable and accrued expenses	\$ 3,580,615	\$ 4,101,079
Accrued incentive compensation	13,900,000	16,111,250
Income tax payable		855,285
Total liabilities	17,480,615	21,067,614
<b>Commitments and contingencies</b>		
<b>Shareholders' Equity</b>		
Common stock, no par value 7,000,000 shares authorized; 2,995,235 issued and outstanding at September 30, 2011; 2,795,683 issued and outstanding at December 31, 2010	49,890,340	34,423,011
Preferred stock, undesignated, 1,000,000 shares authorized and unissued		
Deferred compensation	(12,551,515)	(7,137,729)
Retained earnings/(Accumulated deficit)	(9,887,179)	(19,787,030)
Total shareholders' equity	27,451,646	7,498,252
Total liabilities and shareholders' equity	\$ 44,932,261	\$ 28,565,866
Book value per share	\$ 9.17	\$ 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 September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>REVENUES:</b>				
Investment advisory	\$ 13,465,140	\$ 12,215,574	\$ 42,704,464	\$ 35,629,445
Mutual fund administration, net	1,904,733	1,827,426	5,942,680	5,558,699
Total revenue	15,369,873	14,043,000	48,647,144	41,188,144
<b>OPERATING EXPENSES:</b>				
Compensation and related costs	7,968,737	8,095,735	26,082,794	23,707,288
General and administrative	1,060,295	856,058	3,142,747	2,539,120
Sales and marketing	267,224	143,689	767,391	481,709
Third party distribution	180,226	238,890	661,208	756,546
Mutual fund administration	449,820	509,598	1,249,849	1,473,933
Total operating expenses	9,926,302	9,843,970	31,903,989	28,958,596
<b>NET OPERATING INCOME</b>	5,443,571	4,199,030	16,743,155	12,229,548
Investment return	(1,309,169)	1,169,916	(848,026)	231,130
<b>INCOME BEFORE TAXES</b>	4,134,402	5,368,946	15,895,129	12,460,678
Income tax provision	(1,595,174)	(1,930,540)	(5,995,278)	(4,522,093)
<b>NET INCOME</b>	\$ 2,539,228	\$ 3,438,406	\$ 9,899,851	\$ 7,938,585
Earnings per share				
Basic	\$ 0.84	\$ 1.24	\$ 3.37	\$ 2.88
Diluted	\$ 0.84	\$ 1.24	\$ 3.37	\$ 2.88
Weighted average shares outstanding				
Basic	3,005,504	2,779,345	2,937,403	2,757,539
Diluted	3,005,504	2,779,345	2,937,403	2,759,066

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)**

	Nine Months Ended September 30,	
	2011	2010
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net Income	\$ 9,899,851	\$ 7,938,585
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation on furniture and equipment	247,993	243,161
Stock-based compensation	3,086,851	1,947,623
(Increase) decrease in accounts receivable	86,169	1,827,304
Increase (decrease) in deferred income taxes	(1,203,598)	(449,201)
Investment gain/loss, net	866,697	706,745
Increase (decrease) in accrued liabilities	4,730,270	3,504,491
Other changes in assets and liabilities	(1,253,727)	(1,175,670)
Net cash provided by (used in) operating activities	16,460,506	14,543,038
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of furniture and equipment	(227,774)	(53,642)
Cost of investments purchased and other portfolio activity	(925,507)	(889,133)
Proceeds from sale of investments	2,333,000	3,050,000
Net cash provided by (used in) investing activities	1,179,719	2,107,225
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Payment for repurchase of common shares	(1,072,908)	
Payment of taxes withheld on employee stock transactions	(141,442)	(11,360)
Proceeds from common stock issuance	718,966	688,398
Net cash provided by (used in) financing activities	(495,384)	677,038
<b>CASH AND CASH EQUIVALENTS</b>		
Net change during the period	17,144,841	17,327,301
At beginning of period	5,775,526	11,513,194
At end of period	\$ 22,920,367	\$ 28,840,495
Supplemental cash flow information:		
Interest paid	\$	\$
Income taxes paid	8,343,676	6,088,700
Supplemental disclosure of non-cash transactions:		
Issuance of common stock as incentive compensation	7,461,984	5,003,146



Dividend Payable

36,263,591

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.

**Table of Contents**Note 2 Significant Accounting Policies (Continued)Accounts Receivable

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

	September 30, 2011	December 31, 2010
Level 1 Inputs	\$ 1,137,421	\$ 1,265,998
Level 2 Inputs	8,115,449	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 September 30,			
		2011		2010	
AUM	Contractual Period Ends Quarterly	\$	82,972,698	\$	105,112,498
AUM	Contractual Period Ends Annually		83,941,115		164,760,591
	Total AUM Subject to Performance Incentive	\$	166,913,813	\$	269,873,089
		For The Three Months Ending		For The Nine Months Ending	
		Sept. 30,		Sept. 30,	
		2011	2010	2011	2010
Performance Incentive Fees	Method 1	\$	3,934	\$	1,245
Performance Incentive Fees	Method 2	\$	37,823	\$	1,245
				\$	3,934
				\$	37,823

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## 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.

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## 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 Sept. 30, 2011	2010	Nine Months Ended Sept. 30, 2011	2010
Mutual fund administration:				
Administration revenue, gross	\$ 2,829,944	\$ 2,618,017	\$ 8,802,865	\$ 8,180,583
12b-1/service fees and commission revenue received from fund clients	1,663,549	1,903,486	5,437,354	6,223,147
12b-1/service fees and commission expense payments to third parties	(1,663,549)	(1,903,486)	(5,437,354)	(6,223,147)
Fund related expense	(934,701)	(824,032)	(2,892,596)	(2,700,106)
Revenue, net of fund related expenses	1,895,243	1,793,985	5,910,269	5,480,477
DHCM C-Share financing:				
Broker commission advance repayments	79,780	179,531	286,890	500,895
Broker commission amortization	(70,290)	(146,090)	(254,479)	(422,673)
Financing activity, net	9,490	33,441	32,411	78,222
Mutual fund administration revenue, net	\$ 1,904,733	\$ 1,827,426	\$ 5,942,680	\$ 5,558,699

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 September 30, 2011, there were no warrants outstanding.

**Table of Contents****Note 3 Investment Portfolio**

As of September 30, 2011, the Company held investments worth \$9.3 million and an estimated cost basis of \$7.2 million. The following table summarizes the market value of these investments as of September 30, 2011 and December 31, 2010:

	September 30, 2011	December 31, 2010
Diamond Hill Small Cap Fund	\$ 178,318	\$ 211,301
Diamond Hill Small-Mid Cap Fund	186,982	217,915
Diamond Hill Large Cap Fund	189,684	210,413
Diamond Hill Select Fund	195,080	221,491
Diamond Hill Long-Short Fund	193,370	206,312
Diamond Hill Strategic Income Fund	193,987	198,566
Diamond Hill Investment Partners, L.P.	970,612	1,177,098
Diamond Hill Investment Partners II, L.P.	947,772	1,155,022
Diamond Hill Research Partners, L.P.	5,291,354	7,928,942
Diamond Hill Research Partners International, L.P.	905,711	
<b>Total Investment Portfolio</b>	<b>\$ 9,252,870</b>	<b>\$ 11,527,060</b>

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

	September 30, 2011	As of December 31, 2010
Total partnership assets	\$ 124,827,628	\$ 173,007,238
Total partnership liabilities	22,556,955	32,855,190
Net partnership assets	\$ 102,270,673	\$ 140,152,048
DHCM's portion of net assets	\$ 8,115,449	\$ 10,261,062

	For the Nine Months Ended September 30, 2011	For the Year Ended December 31, 2010
Net partnership income	\$ (21,107,125)	\$ 4,486,719
DHCM's portion of net income	\$ (737,615)	\$ 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.

**Table of Contents**Note 4 Capital Stock (Continued)Authorization of Preferred Shares

The Company's Articles of Incorporation authorize the issuance of 1,000,000 shares of blank check preferred shares with such designations, rights and preferences, as may be determined from time to time by the Company's Board of Directors. The Board of Directors is authorized, without shareholder approval, to issue preferred stock with dividend, liquidation, conversion, voting, or other rights, which could adversely affect the voting or other rights of the holders of the Common Shares. There were no shares of preferred stock issued or outstanding at September 30, 2011 or December 31, 2010.

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

At the Company's annual shareholder meeting on April 26, 2011, shareholders approved the 2011 Equity and Cash Incentive Plan ( 2011 Plan ). The 2011 Plan is intended to facilitate the Company's ability to attract and retain staff, provide additional 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 September 30, 2011, there were 494,625 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.

*Restricted Stock Grant Transactions*

The following table represents a roll-forward of outstanding restricted stock grants issued pursuant to the 2011 and 2005 Plans and related activity during the nine months ended September 30, 2011:

	Shares	Weighted-Average Grant Date Price per Share
Outstanding restricted stock grants as of December 31, 2010	164,832	\$ 69.35
Granted to Employees	107,833	79.53
Grants Vested	(4,528)	80.62
Grants Forfeited	(4,368)	69.78
Total outstanding restricted stock grants as of September 30, 2011	263,769	\$ 73.51



**Table of Contents**Note 5 Stock-Based Compensation (Continued)Equity Incentive Plans (Continued)*Restricted Stock Grant Transactions (Continued)*

Total deferred compensation related to unvested restricted stock grants was \$12,551,515 as of September 30, 2011. Expense recognition of deferred compensation over the remaining vesting periods is as follows:

2011	2012	2013	2014	2015	2016	Total
\$ 969,545	\$ 3,722,357	\$ 3,115,603	\$ 2,800,711	\$ 1,886,188	\$ 57,111	\$ 12,551,515

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 nine months ended September 30, 2011 and 2010:

	2011	2010
Three Months Ended	\$ 239,525	\$ 224,819
Nine Months Ended	718,967	665,897

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 September 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 September 30, 2010		\$
Exercisable September 30, 2010		\$

**Table of Contents****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 nine months ended September 30, 2011 and 2010:

	September 30, 2011	September 30, 2010
Three Months Ended	\$ 163,496	\$ 145,335
Nine Months Ended	450,517	428,340

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

2011	2012	2013	2014	2015	Thereafter
\$ 108,000	\$ 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 nine months ended September 30, 2011 and 2010 consists of federal, state and city income taxes. As of September 30, 2011, the Company and its subsidiaries had a capital loss carry forward of approximately \$2.2 million. The capital loss carry forward is available to offset capital gains in future years.

**Note 8 Earnings Per Share**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Basic and Diluted net income	\$ 2,539,228	\$ 3,438,406	\$ 9,899,851	\$ 7,938,585
Weighted average number of outstanding shares				
Basic	3,005,504	2,779,345	2,937,403	2,757,539
Diluted	3,005,504	2,779,345	2,937,403	2,759,066
Earnings per share				
Basic	\$ 0.84	\$ 1.24	\$ 3.37	\$ 2.88
Diluted	\$ 0.84	\$ 1.24	\$ 3.37	\$ 2.88

**Table of Contents**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 September 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 September 30, 2011 and December 31, 2010:

	September 30, 2011	December 31, 2010
Net Capital	\$ 224,002	\$ 86,107
Minimum Net Capital Requirement	42,431	50,440
Ratio of Aggregate Indebtedness to Net Capital	2.84 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 and nine month periods ending September 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 nine month periods ended September 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 September 30, 2011, AUM totaled \$7.7 billion, a 9% increase in comparison to September 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 three and nine months ended September 30, 2011 and 2010:

**Assets Under Management by Product**  
As of September 30,

(in millions)	2011	2010	% Change
Mutual funds	\$ 3,711	\$ 3,881	-4%
Separate accounts	2,977	2,851	4%
Sub-advised mutual funds	873	145	502%
Private investment funds	158	203	-22%
Total AUM	\$ 7,719	\$ 7,080	9%

**Assets Under Management**  
by Investment Objective  
As of September 30,

(in millions)	2011	2010	% Change
Small	\$ 843	\$ 803	5%
Small-Mid Cap	256	167	53%
Large Cap	4,218	3,296	28%
Select	338	398	-15%
Long-Short	1,895	2,235	-15%
Strategic Income	169	181	-7%
Total AUM	\$ 7,719	\$ 7,080	9%

**Change in Assets Under Management**  
For the Three Months Ended  
September 30,

(in millions)	2011	2010
AUM at beginning of the period	\$ 9,186	\$ 6,482
Net cash inflows (outflows)		
mutual funds	(93)	(25)
sub-advised mutual funds	(37)	(1)
separate accounts	(29)	95
private investment funds	0	(8)
	(159)	61
Net market appreciation (depreciation) and income	(1,308)	537
Increase (decrease) during the period	(1,467)	598
AUM at end of the period	\$ 7,719	\$ 7,080



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(in millions)	<b>Change in Assets Under Management For the Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
AUM at beginning of the period	\$ 8,623	\$ 6,283
Net cash inflows (outflows)		
mutual funds	(91)	415
sub-advised mutual funds	40	(2)
separate accounts	5	387
private investment funds	(20)	(9)
	(66)	791
Net market appreciation (depreciation) and income	(838)	6
Increase (decrease) during the period	(904)	797
AUM at end of the period	\$ 7,719	\$ 7,080

**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 Sept. 30,			Nine Months Ended Sept. 30,		
	2011	2010	%	2011	2010	%
Net operating income	\$ 5,444	\$ 4,199	30%	\$ 16,743	\$ 12,230	37%
Net operating income after tax <sup>(a)</sup>	\$ 3,344	\$ 2,689	24%	\$ 10,428	\$ 7,792	34%
Net income	\$ 2,539	\$ 3,438	-26%	\$ 9,900	\$ 7,939	25%
Net operating income after tax per share <sup>(a)</sup>						
Basic	\$ 1.11	\$ 0.97	14%	\$ 3.55	\$ 2.83	25%
Diluted	\$ 1.11	\$ 0.97	14%	\$ 3.55	\$ 2.82	26%
Net income per share						
Basic	\$ 0.84	\$ 1.24	-32%	\$ 3.37	\$ 2.88	17%
Diluted	\$ 0.84	\$ 1.24	-32%	\$ 3.37	\$ 2.88	17%
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 23 of this report.

**Three Months Ended September 30, 2011 compared with Three Months Ended September 30, 2010**

The Company generated net income of \$2,539,228 (\$0.84 per diluted share) for the three months ended September 30, 2011, compared with net income of \$3,438,406 (\$1.24 per diluted share) for the three months ended September 30, 2010. Revenue for the period increased \$1.3 million. This increase was primarily offset by a decrease in investment return of \$2.5 million, which led to the \$900 thousand decrease in net income. Operating profit margin increased to 35% for third quarter 2011 from 30% for third 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.





Table of Contents**Revenue**

(in thousands)	Three Months Ended September 30,		% Change
	2011	2010	
Investment advisory	\$ 13,465	\$ 12,216	10%
Mutual fund administration, net	1,905	1,827	4%
Total	\$ 15,370	\$ 14,043	9%

As a percent of total third 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 third quarter 2010.

**Large Cap Fee Reduction.** Effective October 1, 2011, the Company voluntarily lowered the investment advisory fee it charges the Diamond Hill Large Cap Fund and certain large cap separate accounts by 0.05%. The large cap strategy fees were reduced to better align the Company's investment advisory fees with its investment management goals. Based on September 30, 2011 AUM, the Company estimates this fee reduction will lower annualized revenue by \$830,000 or 1.30%. If this fee reduction had been in place for the quarter ended September 30, 2011, the average advisory fee rate for the quarter would have decreased from 0.63% to 0.62%.

**Investment Advisory Fees.** Investment advisory fees increased by \$1.2 million, or 10%, from the quarter ended September 30, 2010 to the quarter ended September 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 September 30, 2011 was 0.63% compared to 0.72% for the three months ended September 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 September 30, 2011 compared to 32% of total AUM as of September 30, 2010 while long only strategies, which have a lower advisory fee, made up 59% of total AUM as of September 30, 2011 compared to 52% of total AUM as of September 30, 2010. The Company's average AUM during the quarter ended September 30, 2011 was \$8.5 billion compared to \$6.8 billion for the quarter ended September 30, 2010. Despite the 0.09% decrease in average advisory fee rate during third quarter 2011 compared to third quarter 2010, the fee rate was being charged on a greater asset base as the average AUM increased 26% from third quarter 2010 to third quarter 2011 resulting in an increase in the overall fees earned during the period.

**Mutual Fund Administration Fees.** Mutual fund administration fees increased \$78 thousand, or 4%, from the quarter ended September 30, 2010 to the quarter ended September 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 an 8% increase in average mutual fund AUM from \$3.8 billion for the quarter ended September 30, 2010 to \$4.1 billion for the quarter ended September 30, 2011. The overall blended net administration fee rate remained constant at 0.16% from the quarter ended September 30, 2010 to the quarter ended September 30, 2011.

Table of Contents**Expenses**

(in thousands)	Three Months Ended September 30,		% Change
	2011	2010	
Compensation and related costs	\$ 7,969	\$ 8,096	-2%
General and administrative	1,060	856	24%
Sales and marketing	267	144	85%
Third party distribution	180	239	-25%
Mutual fund administration	450	509	-12%
Total	\$ 9,926	\$ 9,844	1%

**Compensation and Related Costs.** Employee compensation and benefits decreased \$127 thousand, or 2%, during the three months ended September 30, 2011 compared to the same period a year ago primarily due to a \$370 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 \$218 thousand increase in base salaries and related benefits due an increase in employee headcount, offset by a \$715 thousand decrease in incentive compensation from third quarter 2010 to third quarter 2011.

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 \$204 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, expansion of the Company's office space, an increase in information technology related expenses, and an increase in regulatory expense.

**Sales and Marketing.** Sales and marketing expenses increased by \$123 thousand, or 85%. The increase was primarily due to an increase in travel and other expenses related to business development and retention efforts during third 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 \$59 thousand, or 12%, period over period. The majority of mutual fund administration fees are variable based on the amount of mutual fund AUM. The decrease in mutual fund administration expenses is primarily due to a third party service provider fee reduction effective October 1, 2010.

**Nine Months Ended September 30, 2011 compared with Nine Months Ended September 30, 2010**

The Company generated net income of \$9,899,851 (\$3.37 per diluted share) for the nine months ended September 30, 2011, compared with net income of \$7,938,585 (\$2.88 per diluted share) for the nine months ended September 30, 2010. While net income increased \$2.0 million, revenue for the period increased \$7.4 million offset by a \$2.9 million increase in operating expenses, a \$1.1 million decrease in net investment return and a \$1.4 million increase in the income tax provision from the nine months ended September 30, 2010 to the nine months ended September 30, 2011. Operating profit margin increased to 34% for the nine months ended September 30, 2011 from 30% for the nine months ended September 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.



Table of Contents**Revenue**

(in thousands)	Nine Months Ended September 30,		% Change
	2011	2010	
Investment advisory	\$ 42,704	\$ 35,629	20%
Mutual fund administration, net	5,943	5,559	7%
Total	\$ 48,647	\$ 41,188	18%

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 87% and mutual fund administration fees accounted for the remaining 13% of revenues.

**Large Cap Fee Reduction.** Effective October 1, 2011, the Company voluntarily lowered the investment advisory fee it charges the Diamond Hill Large Cap Fund and certain large cap separate accounts by 0.05%. The large cap strategy fees were reduced to better align the Company's investment advisory fees with its investment management goals. Based on September 30, 2011 AUM, the Company estimates this fee reduction will lower annualized revenue by \$830,000 or 1.30%. If this fee reduction had been in place for the quarter ended September 30, 2011, the average advisory fee rate for the quarter would have decreased from 0.63% to 0.62%.

**Investment Advisory Fees.** Investment advisory fees increased by \$7.1 million, or 20%, for the nine months ended September 30, 2011 compared to the nine months ended September 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 nine months ended September 30, 2011 was 0.64% compared to 0.71% for the nine months ended September 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 September 30, 2011 compared to 32% of total AUM as of September 30, 2010 while long only strategies, which have a lower advisory fee, made up 59% of total AUM as of September 30, 2011 compared to 52% of total AUM as of September 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 33% from the nine months ended September 30, 2010 to the nine months ended September 30, 2011 resulting in an increase in the overall fees earned during the period.

**Mutual Fund Administration Fees.** Mutual fund administration revenues increased by \$384 thousand, or 7%, for the nine months ended September 30, 2011 compared to the nine months ended September 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 14% increase in average mutual fund AUM from \$3.7 billion for the nine months ended September 30, 2010 to \$4.2 billion for the nine months ended September 30, 2011 offset by a decrease in the overall blended net administration fee rate from 0.17% for the nine months ended September 30, 2010 to 0.15% for the nine months ended September 30, 2011.

**Table of Contents****Expenses**

(in thousands)	Nine Months Ended September 30,		% Change
	2011	2010	
Compensation and related costs	\$ 26,083	\$ 23,707	10%
General and administrative	3,143	2,539	24%
Sales and marketing	767	482	59%
Third party distribution	661	757	-13%
Mutual fund administration	1,250	1,474	-15%
Total	\$ 31,904	\$ 28,959	10%

**Compensation and Related Costs.** Employee compensation and benefits increased \$2.4 million, or 10%, during the nine months ended September 30, 2011 compared to the same period a year ago, primarily due to an increase of \$1.1 million due to an overall increase in the total amount of long-term equity awards outstanding in 2011 compared to 2010, an increase of \$1.0 million in incentive compensation during the period consistent with a 9% increase in AUM and the associated increase in operating income, and base salaries and related benefits, which increased by \$272 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 \$604 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, expansion of the Company's office space, the implementation of a new trading system during second quarter 2010, and an increase in information technology related expenses and corporate legal costs, and an increase in regulatory expense.

**Sales and Marketing.** Sales and marketing expenses increased by \$285 thousand, or 59%, 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 \$224 thousand, or 15%, period over period. The majority of mutual fund administration fees are variable based on the amount of mutual fund AUM. 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 12 full-time employees 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 nine months ended September 30, 2011 compared to the three and nine months ended September 30, 2010, excluding 12b-1/service fees and commission revenue and expenses, which net to zero:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenue <sup>1</sup>	\$ 424	\$ 375	\$ 1,364	\$ 1,158
Expenses	631	592	1,880	1,810
Net loss	\$ (207)	\$ (217)	\$ (516)	\$ (652)

<sup>1</sup> Beacon Hill's revenue for the three months ended September 30, 2011 and 2010 includes \$128 thousand and \$119 thousand, respectively, of inter-company revenue earned from services provided to DHCM. Beacon Hill's revenue for the nine months ended September 30, 2011 and 2010 includes \$388 thousand and \$360 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 September 30, 2011, the Company had working capital of approximately \$23.3 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 31,567 shares since third quarter 2007. In the current quarter, 15,462 shares were repurchased from certain employees in a private transaction at the Company's closing price on September 30, 2011. The repurchase was executed under the agreement that the employees would invest the proceeds from such sale into one of the Company's investment strategies in order to further align their interests with the Company's clients.

**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 Sept.		Nine Months Ended Sept.	
	2011	2010	2011	2010
Net operating income, GAAP basis	\$ 5,444	\$ 4,199	\$ 16,743	\$ 12,230
Non-GAAP adjustments:				
Tax provision excluding impact of investment return	2,100	1,510	6,315	4,438
Net operating income after tax, non-GAAP basis	3,344	2,689	10,428	7,792
Net operating income after tax per basic share, non-GAAP basis	\$ 1.11	\$ 0.97	\$ 3.55	\$ 2.83
Net operating income after tax per diluted share, non-GAAP basis	\$ 1.11	\$ 0.97	\$ 3.55	\$ 2.82
Basic weighted average shares outstanding, GAAP basis	3,006	2,779	2,937	2,758
Diluted weighted average shares outstanding, GAAP basis	3,006	2,779	2,937	2,759

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.



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**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.

**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 nine-month period ending September 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.

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

The Company purchased 15,462 shares of its common stock during the nine months ended September 30, 2011. The following table sets forth information regarding the Company's repurchase program of its common stock during the third quarter of fiscal year 2011:

Period	Total Number of Shares Purchased (2)	Average Price Paid Per Share	Total Number of Cumulative 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)
July 1, 2011 through July 31, 2011			16,105	333,895
August 1, 2011 through August 31, 2011			16,105	333,895
September 1, 2011 through September 30, 2011	15,462	\$ 69.39	31,567	318,433

- (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.
- (2) In the current quarter 15,462 shares were repurchased from certain employees in a private transaction at the Company's closing price on September 30, 2011. The repurchase was executed under the agreement that the employees would invest the proceeds from such sale into one of the Company's investment strategies in order to further align their interests with the Company's clients.

**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.
- 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.

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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
October 28, 2011	President, Chief Executive Officer, and a Director	/s/ R. H. Dillon R. H. Dillon
October 28, 2011	Chief Financial Officer, Treasurer, and Secretary	/s/ James F. Laird James F. Laird