

DIAMOND HILL INVESTMENT GROUP INC

Form 10-Q

November 09, 2007

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**U.S. 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, 2007  
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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer:  Accelerated filer:  Non-accelerated filer:

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 the latest practicable date, November 1, 2007, is 2,219,381 shares.

DIAMOND HILL INVESTMENT GROUP, INC.

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

	9/30/2007 (Unaudited)	12/31/2006
<b>ASSETS</b>		
Cash and cash equivalents	\$ 18,253,867	\$ 9,836,989
Investment portfolio	19,434,079	19,108,682
Accounts receivable	5,935,180	6,924,008
Prepaid expenses	1,089,780	869,501
Furniture and equipment, net of depreciation and other assets	651,831	497,297
Total assets	\$ 45,364,737	\$ 37,236,477
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Liabilities		
Accounts payable and accrued expenses	775,121	1,217,114
Accrued incentive compensation	9,301,580	13,637,000
Current and deferred taxes	1,456,296	1,899,106
Total Liabilities	11,532,997	16,753,220
Commitments and contingencies		
Shareholders Equity		
Common stock, no par value		
7,000,000 shares authorized; 2,218,940 issued		
2,218,940 outstanding at September 30, 2007		
1,838,435 outstanding at December 31, 2006		
	24,392,704	16,515,256
Preferred stock, undesignated, 1,000,000 shares authorized and unissued		
Treasury stock, at cost		
0 shares at September 30, 2007		
10,037 shares at December 31, 2006		
		(95,736)
Deferred compensation	(3,329,475)	(2,355,499)
Retained earnings	12,768,511	6,419,236
Total shareholders equity	33,831,740	20,483,257
Total liabilities and shareholders equity	\$ 45,364,737	\$ 37,236,477

See notes to consolidated financial statements.



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

	Three Months Ended Sept 30,		Nine Months Ended Sept 30,	
	2007	2006	2007	2006
<b>REVENUES:</b>				
Investment advisory	\$ 9,215,700	\$ 5,636,902	\$ 25,979,666	\$ 13,566,910
Performance incentive	1,520		5,817	2,509,875
Mutual fund administration, net	1,484,121	1,017,711	4,439,441	2,406,904
Total revenue	10,701,341	6,654,613	30,424,924	18,483,689
<b>OPERATING EXPENSES:</b>				
Compensation and related costs	5,074,607	3,719,230	14,948,034	10,638,098
General and administrative	973,758	281,243	2,141,463	791,393
Sales and marketing	106,809	86,009	348,619	218,752
Third party distribution	404,419	125,484	1,127,680	327,403
Mutual fund administration	608,258	421,488	1,816,813	1,186,842
Total operating expenses	7,167,851	4,633,454	20,382,609	13,162,488
<b>NET OPERATING INCOME</b>	3,533,490	2,021,159	10,042,315	5,321,201
Investment return	534,594	113,187	733,720	903,287
<b>INCOME BEFORE TAXES</b>	4,068,084	2,134,346	10,776,035	6,224,488
Income tax provision	(1,419,791)	(772,101)	(3,719,733)	(2,241,463)
<b>NET INCOME</b>	\$ 2,648,293	\$ 1,362,245	\$ 7,056,302	\$ 3,983,025
Earnings per share				
Basic	\$ 1.20	\$ 0.76	\$ 3.31	\$ 2.24
Diluted	\$ 1.14	\$ 0.61	\$ 3.13	\$ 1.81
Weighted average shares outstanding				
Basic	2,204,641	1,789,147	2,130,867	1,775,633
Diluted	2,322,281	2,239,245	2,251,407	2,204,621

See notes to consolidated financial statements.

**Table of Contents****Diamond Hill Investment Group, Inc.  
Consolidated Statement of Shareholders Equity (unaudited)**

	Shares Outstanding	Common Stock	Treasury Stock	Deferred Compensation	Retained Earnings	Total
Balance at January 1, 2007	1,838,435	\$ 16,515,256	\$ (95,736)	\$ (2,355,499)	\$ 6,419,236	\$ 20,483,257
Deferred compensation	21,000	1,914,180		(1,914,180)		
Recognition of current year deferred compensation				940,204		940,204
Issuance of stock grants	57,254	5,628,641				5,628,641
Issuance of common stock related to 401k plan match	1,113	85,788				85,788
FAS 123R compensation expense		6,812				6,812
Tax benefit from options and warrants exercised		3,776,382				3,776,382
Payment of taxes withheld related to option exercises	(85,518)	(8,020,273)				(8,020,273)
Purchase of treasury stock related to option exercises	(15,585)		(1,344,958)			(1,344,958)
Sale of treasury stock	25,622	140,019	1,440,694		(707,027)	873,686
Exercise of options/warrants for common stock	378,017	4,447,841				4,447,841
Repurchase of common stock	(1,398)	(101,942)				(101,942)
Net income					7,056,302	7,056,302
Balance at September 30, 2007	2,218,940	\$ 24,392,704	\$	\$ (3,329,475)	\$ 12,768,511	\$ 33,831,740

See notes to consolidated financial statements.



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

	Nine Months Ended September 30,	
	2007	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net Income	\$ 7,056,302	\$ 3,983,025
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation on furniture and equipment	113,089	44,724
Amortization of deferred compensation	940,204	149,931
(Increase) decrease in accounts receivable	(988,828)	(1,760,424)
Increase in deferred taxes	1,762,158	2,180,116
Stock option expense	6,812	24,582
(Increase) decrease in unrealized gains	(195,853)	(684,669)
Increase (decrease) in accrued liabilities	(4,777,413)	6,497,626
Other changes in assets and liabilities	(220,279)	(210,034)
Net cash provided by (used in) operating activities	3,696,192	10,224,877
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of furniture and equipment	(267,623)	(408,024)
Investment portfolio activity	(129,544)	(6,772,659)
Net cash used in investing activities	(397,167)	(7,180,683)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Payment of taxes withheld on option/warrant exercises	(8,020,273)	
Proceeds from common stock issuance	13,042,390	161,994
Purchase of treasury stock	(1,344,958)	
Sale of treasury stock	1,440,694	267,925
Net cash provided by financing activities	5,117,853	429,919
<b>CASH AND CASH EQUIVALENTS</b>		
Net change during the period	8,416,878	3,474,113
At beginning of period	9,836,989	2,532,334
At end of period	\$ 18,253,867	\$ 6,006,447
Cash paid during the period for:		
Interest		
Income taxes	\$ 520,560	\$ 60,000
See notes to consolidated financial statements.		



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**Diamond Hill Investment Group, Inc.**

**Notes to Consolidated Financial Statements (unaudited)**

Note 1 Organization

Diamond Hill Investment Group, Inc. (the Company) was incorporated as a Florida corporation in April 1990 and in May 2002 merged into an Ohio corporation formed for the purpose of reincorporating in Ohio, where the Company's principal place of business is located. The Company has two 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 (the 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, which partnership will act 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. Diamond Hill GP (Cayman) Ltd. has no operating activity.

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. The following is a summary of the Company's significant accounting policies:

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year financial presentation.

Principles of Consolidation

The accompanying consolidated financial statements include the operations of the Company, DHCM, and DHGP. All material inter-company transactions and balances have been eliminated in consolidation.

Segment Information

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, establishes disclosure requirements relating to operating segments in annual and interim financial statements. Management has determined that the Company operates in one business segment, namely as an investment adviser managing mutual funds, separate accounts, and private investment funds.

Cash and Cash Equivalents

Cash and cash equivalents include demand deposits and money market funds.

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, 2007 or December 31, 2006.

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Note 2 **Significant Accounting Policies (Continued)**

**Valuation of Investment Portfolio**

Investments in mutual funds are valued at their current net asset value. Investments in Private Funds are valued based on readily available market quotations. The market value adjustments on the investments are recorded in the Consolidated Statement of Income as investment returns.

**Limited Partnership Interests**

DHCM is the managing member of Diamond Hill General Partner, LLC, the General Partner of Diamond Hill Investment Partners, LP ( DHIP ) and Diamond Hill Investment Partners II, LP ( DHIP II ), each a limited partnership whose underlying assets consist of marketable securities. DHCM's investment in DHIP and DHIP II is accounted for using the equity method, under which DHCM's share of the net earnings or losses from the partnership is reflected in income as earned, and distributions received are reflected as reductions from the investment. Several directors, 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 DHIP or DHIP II. 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, is carried at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over estimated lives of three to seven years.

**Treasury Stock**

Treasury stock purchases are accounted for under the cost method. The subsequent issuances of these shares are accounted for based on their weighted-average cost basis. During the quarter ended September 30, 2007, the Company exhausted all Treasury Stock.

**Revenue Recognition**

The Company earns substantially all of its revenue from investment advisory and fund administration services. Mutual fund investment advisory and administration fees, 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.

**Table of Contents**Note 2 Significant Accounting Policies (Continued)Revenue Recognition (Continued)

The Company's private investment funds and certain managed accounts provide for performance incentive fees. EITF Abstract Topic No. D-96, "Accounting for Management Fees Based on a Formula", identifies 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 the more conservative method (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. As of September 30, 2007 assets under management which are subject to an incentive fee totaled \$622 million. 37% of these assets are in accounts that are subject to a contractual period that ends on each calendar quarter. Incentive fees related to those accounts are recorded as revenue each calendar quarter. The remaining 63% of the incentive fee assets are in accounts that are subject to a contractual period that ends annually on December 31. Incentive fees on those accounts that would be due if the annual contract period ended on September 30, 2007 and 2006 would be as follows:

Three months ended September 30, 2007:	\$ 68,642
Nine months ended September 30, 2007:	\$ 68,642
Three months ended September 30, 2006:	\$ 0
Nine months ended September 30, 2006:	\$ 0

Revenue Recognition - Mutual Fund Administration

DHCM has an administrative, fund accounting and transfer agency services agreement with the Funds, under which DHCM performs certain services for each series of the trust. These services include mutual fund administration, accounting, transfer agency and other related functions. For performing these services, each series of the trust compensates DHCM a fee at an annual rate of 0.32% for Class A and Class C shares and 0.18% for Class I shares times each series' average daily net assets. Effective April 30, 2007, DHCM reduced the fee it charges for administrative services from 0.36% to 0.32% for Class A and Class C shares. In fulfilling its role under this agreement, DHCM has engaged several third-party providers, and the cost for their services is paid by DHCM. A portion of these expenses could, and are typically, paid for directly by the Funds and are classified below as fund related. These expenses include, among others, required fund shareholder mailings, registration fees, legal and audit fees. DHCM's agreement, however, requires that DHCM pay for essentially all fund administration expenses, including those that could be paid directly by the Funds. In addition, DHCM finances the up-front commissions paid to brokers who sell C shares of the Funds. As financier, DHCM advances the commission to the selling broker at the time of sale. This commission advance is capitalized and amortized over 12 months to correspond with the payments DHCM receives from the principal underwriter to recoup this commission payment. Mutual fund administration (admin) gross and net revenue are summarized below:

	Three Months Ended Sept		Nine Months Ended Sept 30,	
	2007	2006	2007	2006
Mutual fund admin revenue, gross	\$ 2,035,329	\$ 1,622,207	\$ 6,195,872	\$ 3,965,176
Mutual fund admin, fund related expense	607,548	627,200	1,846,107	1,626,527
Mutual fund admin revenue, net of fund related expenses	1,427,781	995,007	4,349,765	2,338,649
C-Share broker commission advance repayments	550,857	319,300	1,464,002	850,394
C-Share broker commission amortization	494,517	296,596	1,374,326	782,139

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C-Share financing activity, net	56,340	22,704	89,676	68,255
Mutual fund administration revenue, net	\$ 1,484,121	\$ 1,017,711	\$ 4,439,441	\$ 2,406,904

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Note 2 Significant Accounting Policies (Continued)

Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 109 Accounting for Income Taxes ( SFAS 109 ). 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.

Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48 - Accounting for the Uncertainty in Income Taxes ( FIN 48 ), an interpretation of SFAS 109. As a result of the implementation of FIN 48, the Company recognized no adjustment in the net 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 options, warrants, and restricted stock units to issue common stock were exercised.

**Table of Contents**Note 3 Investment Portfolio

As of September 30, 2007, the Company held investments worth approximately \$19.4 million with a cost basis of approximately \$16.1 million. The following table summarizes the market value of these investments as of September 30, 2007 and December 31, 2006:

	September 30, 2007	December 31, 2006
Diamond Hill Small Cap Fund	\$ 65,814	\$ 65,371
Diamond Hill Small-Mid Cap Fund	340,544	330,546
Diamond Hill Large Cap Fund	315,545	292,369
Diamond Hill Select Fund	371,857	342,121
Diamond Hill Long-Short Fund	303,736	295,953
Diamond Hill Financial Long-Short Fund	291,675	300,000
Diamond Hill Strategic Income Fund	2,938,704	2,916,069
Diamond Hill Investment Partners, L.P.	9,907,429	9,744,285
Diamond Hill Investment Partners II, L.P.	4,898,775	4,821,968
 Total Investment Portfolio	 \$ 19,434,079	 \$ 19,108,682

DHCM is the managing member of the General Partner of DHIP and DHIP II, whose underlying assets consist primarily of marketable securities. The General Partner is contingently liable for all of the partnership's liabilities. Summary financial information, including the Company's carrying value and income from these partnerships at September 30, 2007 and December 31, 2006 and for the nine and twelve months then ended, is as follows:

	2007	2006
Total assets	\$384,067,028	\$357,375,152
Total liabilities	97,995,265	146,918,057
Net assets	286,071,763	210,457,095
Net income	2,613,244	35,961,019
 DHCM's portion of net assets	 14,806,204	 14,566,253
DHCM's portion of net income	234,134	6,515,194

DHCM's income from these partnerships includes its pro-rata capital allocation and its share of any incentive allocation from the limited partners.



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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 empowered, 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, 2007 or December 31, 2006.

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 Plan authorizes the issuance of Common Shares of the Company in various forms of stock or option grants. As of September 30, 2007 shares available for issuance under the Plan are 440,250. The Plan provides that the Board of Directors, or a committee appointed by the Board, may grant awards and otherwise administer the Plan.

*1993 Non-qualified and Incentive Stock Option Plan*

The Company adopted a Non-Qualified and Incentive Stock Option Plan in 1993 that authorized the grant of options to purchase an aggregate of 500,000 shares of the Company's Common Stock. The Plan provided that the Board of Directors, or a committee appointed by the Board, may grant options and otherwise administer the Option Plan. This Plan expired by its terms in November 2003. Options outstanding under this Plan are not affected by the Plan's expiration.

Equity Compensation Grants

On May 13, 2004 the Company's shareholders approved terms and conditions of certain equity compensation grants to three key employees. Under the approved terms a total of 75,000 shares of restricted stock and restricted stock units were issued to the key employees on May 31, 2004. The restricted stock and restricted stock units are restricted from sale and do not vest until May 31, 2009.

401(k) Plan

The Company sponsors a 401(k) plan whereby all employees participate in the plan. 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 September 30, 2007 and 2006, expense attributable to the plan was \$111,505 and \$80,727, respectively. For the nine months ended September 30, 2007 and 2006, expense attributable to the plan was \$321,182 and \$230,522, respectively.

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Note 5 Stock-Based Compensation (Continued)

Effective October 1, 2005, the Company adopted SFAS No. 123(R), Accounting for Stock-Based Compensation ( SFAS 123R ). SFAS 123R requires all share-based payments to employees and directors, including grants of stock options, to be recognized as expense in the income statement based on their fair values. The amount of compensation is measured at the fair value of the options when granted, and this cost is expensed over the required service period, which is normally the vesting period of the options. SFAS 123R applies to the Company for options granted or modified after October 1, 2005. SFAS 123R also requires compensation cost to be recorded for prior option grants that vest after the date of adoption.

No options were granted in 2007 or 2006.

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

Stock option and warrant transactions under the various plans are summarized below:

	Options		Warrants	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding December 31, 2005	303,002	14.48	259,400	12.78
Granted				
Expired / Forfeited				
Exercised	10,531	10.38	2,000	11.25
Used in conjunction with cashless exercise	269	28.10		
Outstanding September 30, 2006	292,202	\$ 14.62	257,400	\$ 12.79
Outstanding December 31, 2006	283,102	14.60	249,400	12.57
Granted				
Expired / Forfeited			2,000	10.63
Exercised	178,602	17.36	222,000	8.65
Outstanding September 30, 2007	104,500	\$ 9.87	25,400	\$ 47.00
Exercisable September 30, 2007	84,500	\$ 11.14	25,400	\$ 47.00

The company withheld from issuance 85,518 shares of the 400,602 warrants and options exercised in 2007 to fulfill tax withholding requirements related to employee compensation earned on the exercises.

Options and warrants outstanding and exercisable at September 30, 2007 are as follows:

Options				Warrants			
Number	Remaining Life In Years	Number Exercisable	Exercise Price	Number Outstanding	Remaining Life In Years	Number Exercisable	Exercise Price
10,000	2.86	10,000	7.95	14,000	0.62	14,000	73.75
10,000	3.22	10,000	8.44	400	1.25	400	22.20
19,500	3.22	19,500	28.10	3,000	1.62	3,000	22.50
5,000	3.51	5,000	8.45	6,000	2.42	6,000	11.25
10,000	3.79	10,000	5.25	2,000	2.61	2,000	8.75
50,000	5.68	30,000	4.50				
104,500	4.43	84,500		25,400	1.33	25,400	

The aggregate intrinsic value (shares times the market price) of options and warrants outstanding and exercisable as of September 30, 2007 are:

Outstanding \$10,521,900

Exercisable

\$ 8,901,900

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The Company leases 14,187 square feet of office space at 325 John H. McConnell Blvd, Suite 200, Columbus, Ohio 43215 under an operating lease agreement which terminates on July 31, 2013. Total lease and operating expenses for the three months ended September 30, 2007 and 2006 were \$85,890, and \$57,012, respectively. Total lease and operating expenses for the nine months ended September 30, 2007 and 2006 were \$218,655 and \$134,347, respectively. The future minimum lease payments under the operating lease are approximately as follows:

2007	2008	2009	2010	2011	2012	2013
\$86,000	\$224,000	\$231,000	\$238,000	\$245,000	\$254,000	\$130,000

In addition to the above rent, the Company will also be responsible for normal operating expenses of the property. Such operating expenses were approximately \$8.75 per square foot in 2006, are expected to be \$9.04 in 2007 and may increase by no more than 5% annually thereafter.

**Note 7 Income Taxes**

The provision for income taxes for the three and nine months ended September 30, 2007 and 2006 consists of federal and city income taxes.

The exercise of stock options and warrants during the nine months ended September 30, 2007 resulted in a tax deduction of \$22.7 million, and a corresponding tax benefit of \$8.2 million. In accordance with GAAP, this tax benefit is not reflected in the consolidated statements of income or in earnings per share. \$3.8 million of this \$8.2 million tax benefit has been recorded as a reduction of taxes payable and a corresponding increase in shareholders' equity. While the consolidated statements of income reflect a \$1.4 and \$3.7 million tax expense for the three and nine months ending September 30, 2007, respectively, the Company will not pay any income tax related to the first nine months earnings. The tax benefit will reduce taxes payable in future periods until cumulative taxable income exceeds \$22.7 million.

**Note 8 Earnings Per Share**

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

	Three Months Ended September		Nine Months Ended September	
	30, 2007	2006	30, 2007	2006
Basic and Diluted net income	\$ 2,648,293	\$ 1,362,245	\$ 7,056,302	\$ 3,983,025
Weighted average number of outstanding shares				
Basic	2,204,641	1,789,147	2,130,867	1,775,633
Diluted	2,322,281	2,239,245	2,251,407	2,204,621
Earnings per share				
Basic	\$ 1.20	\$ 0.76	\$ 3.31	\$ 2.24
Diluted	\$ 1.14	\$ 0.61	\$ 3.13	\$ 1.81

The diluted EPS calculation excludes the effect of stock options and warrants when their exercise prices exceed the average market price for the period. For the three and nine months ended September 30, 2006, stock options and warrants for 30,202 were excluded from diluted EPS. For the three and nine months ended September 30, 2007, no stock options and warrants were excluded from diluted EPS.

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Note 9 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 Operation**

**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 and Section 21E of the Securities Exchange Act of 1934 relating to, among other things, 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 "expect", "estimate", "may", "intend", and similar expressions identify forward-looking statements that speak only as of the date thereof. While the Company believes that the assumptions underlying its forward-looking statements are reasonable, investors are cautioned that any of the assumptions could prove to be inaccurate and accordingly, the actual results and experiences of the Company could differ materially from the anticipated results or other expectations expressed by the Company in its forward-looking statements. Factors that could cause such actual results or experiences to differ from results discussed in the forward-looking statements include, but are not limited to: the adverse effect from a decline in the securities markets; a decline in the performance of the Company's products; changes in interest rates; a general 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 other public documents on file with the SEC.

**General**

Diamond Hill Investment Group, Inc. (the "Company"), an Ohio corporation organized in 1990, derives its consolidated revenue and net income from investment advisory services provided by its subsidiary Diamond Hill Capital Management, Inc. ("DHCM"). DHCM is a registered investment adviser under the Investment Advisers Act of 1940 providing investment advisory services to individuals and institutional investors through the Diamond Hill sponsored mutual funds, separate accounts, and private investment funds (generally known as "hedge funds"). The Company was first incorporated in April 1990.

In this section, we discuss and analyze the consolidated results of operations for the three and nine month periods ending September 30, 2007 and 2006 and other factors that may affect future financial performance. This discussion should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements, and Selected Financial Data.

The Company's revenue is derived primarily from investment advisory and administration fees received from Diamond Hill Funds and investment advisory and performance incentive fees received from separate accounts and private investment funds. Investment advisory and administration fees paid to the Company are based primarily on the value of the investment portfolios managed by the Company and fluctuate with changes in the total value of the assets under management. Such fees are recognized in the period that the Company manages these assets. Performance incentive fees are 20% annually on the amount of client investment performance in excess of a 5% annual return hurdle. Because performance incentive fees are based primarily on the performance of client accounts, they will be volatile from period to period. The Company's major expense is employee compensation and benefits.

**Table of Contents****Assets Under Management**

As of September 30, 2007, assets under management ( AUM ) totaled \$4.4 billion, a 41% increase in comparison to September 30, 2006. The following is a summary of the firm's AUM by product and objective as of September 30, 2007 and 2006:

(in millions)	<b>Assets Under Management by Product As of September 30,</b>		
	<b>2007</b>	<b>2006</b>	<b>% Change</b>
Mutual funds	\$2,889	\$2,193	32%
Separate accounts	1,000	747	34%
Private investment funds	491	177	177%
<b>Total</b>	<b>\$4,380</b>	<b>\$3,117</b>	<b>41%</b>

(in millions)	<b>Assets Under Management by Objective As of September 30,</b>		
	<b>2007</b>	<b>2006</b>	<b>% Change</b>
Small and Small-Mid Cap	\$ 660	\$ 758	-13%
Large Cap and Select	1,028	802	28%
Long-Short	2,394	1,321	81%
Strategic and fixed income	298	236	26%
<b>Total</b>	<b>\$4,380</b>	<b>\$3,117</b>	<b>41%</b>

**Consolidated Results of Operations**

The following is a discussion of the consolidated results of operations of the Company and its revenues and expenses.

	<b>Three Months Ended September 30,</b>			<b>Nine Months Ended September 30,</b>		
	<b>2007</b>	<b>2006</b>	<b>% Change</b>	<b>2007</b>	<b>2006</b>	<b>% Change</b>
Net income (in thousands)	\$2,648	\$1,362	94%	\$7,056	\$3,983	77%
Net income (loss) per share						
Basic	\$ 1.20	\$ 0.76	58%	\$ 3.31	\$ 2.24	48%
Diluted	\$ 1.14	\$ 0.61	87%	\$ 3.13	\$ 1.81	73%
Weighted average shares outstanding (in thousands)						
Basic	2,205	1,789		2,131	1,776	
Diluted	2,322	2,239		2,251	2,205	

**Three Months ended September 30, 2007 compared with Three Months Ended September 30, 2006**



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The Company generated net income of \$2,648,293 (\$1.14 per diluted share) for the three months ended September 30, 2007, compared with net income of \$1,362,245 (\$0.61 per diluted share) for the three months ended September 30, 2006. The increase in profitability is primarily attributable to the Company's investment advisory fee and mutual fund administration fee increase due to an increase in AUM of \$1.3 billion year over year.

**Table of Contents****Revenue**

(in Thousands)	Three Months Ended September 30,		% Change
	2007	2006	
Investment advisory	\$ 9,216	\$5,637	63%
Performance incentive	1		n.m.
Mutual fund administration, net	1,484	1,018	46%
Total	\$10,701	\$6,655	61%

As a percent of total third quarter 2007 revenues, investment advisory fees account for 86%, performance incentive fees accounted for less than 1%, and mutual fund administration fees accounted for the remaining 14% compared to the third quarter of 2006 where investment advisory fees accounted for 85% and mutual fund administration fees accounted for 15% of revenues.

**Investment Advisory Fees.** Investment advisory fees are calculated as a percent of average net assets under management at various levels depending on the investment product. The Company's average advisory fee rate for the three months ended September 30, 2007 was 0.85% compared to 0.74% for the three months ended September 30, 2006. This increase was mainly due to the increase in AUM in the long-short products, which have a higher advisory fee. The overall increase in investment advisory fees was primarily due to an increase in AUM of \$1.3 billion year over year.

**Performance Incentive Fees.** Performance incentive fees are equal to 20% of the performance increase in client accounts after a 5% annual hurdle is achieved. The fees are dependent on both AUM and absolute investment performance in client accounts and will be volatile from period to period. Incentive fee AUM totaled \$622 million at September 30, 2007 compared to \$239 million at September 30, 2006. Incentive fees for the third quarter of 2007 and 2006 were insignificant due to investment performance not exceeding the minimum hurdle for the nine months ended September 30, 2007 and 2006, respectively.

**Mutual Fund Administration Fees.** Mutual fund administration fees are calculated as a percent of average net assets under administration in the Diamond Hill Funds. The Company earns 0.32% on Class A and Class C shares and 0.18% on Class I shares. As assets in the Funds have grown the Company has realized certain economies of scale; and as a result, the Company has lowered its administration fees by approximately 10% in each of the last two years to pass on those economies of scale to fund shareholders. The Company lowered its administration fees again effective April 30, 2007 from 0.36% to 0.32% for Class A and Class C shares. Class I share fees remained unchanged at 0.18%. Despite lowering fees by approximately 10% on April 30, 2007 and 2006, fund administration revenues increased by \$466,000 year over year.

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

(in Thousands)	Three Months Ended September 30,		% Change
	2007	2006	
Compensation and related costs	\$5,075	\$3,719	36%
General and administrative	974	281	247%
Sales and marketing	107	86	24%
Third party distribution	404	125	223%
Mutual fund administration	608	422	44%
Total	\$7,168	\$4,633	55%

**Compensation and Related Costs.** Employee compensation and benefits increased by \$1.4 million, or 36%, during the three months ended September 30, 2007 compared to the three months ended September 30, 2006. This increase is due to an increase in staff and incentive compensation, primarily related to the investment team.

**General and Administrative.** General and administrative expenses increased by \$693,000 or 247%. The majority of this increase related to a trade error which resulted in a \$452,000 loss. The remaining increase resulted from additional investment research costs and other general expenses associated with the Company's growth.

**Sales and Marketing.** Sales and marketing expenses increased by \$21,000 or 24%. This increase was primarily due to increased travel related expenses incurred as a result of new business opportunities.

**Third Party Distribution.** Third party distribution expense represents payments made to intermediaries related to sales of the Company's investment products. The quarter over quarter increases directly correspond to the increase in investment advisory fees earned by the Company.

**Mutual Fund Administration.** Mutual fund administration expense increased by \$186,000 or 44%. A large portion of mutual fund administration expense is calculated based on a percent of assets under administration in the Diamond Hill Funds. The quarter over quarter increase is consistent with the continued growth in assets under administration.

**Table of Contents****Nine Months ended September 30, 2007 compared with Nine Months Ended September 30, 2006**

The Company generated net income of \$7,056,302 (\$3.13 per diluted share) for the nine months ended September 30, 2007, compared with net income of \$3,983,025 (\$1.81 per diluted share) for the nine months ended September 30, 2006. The increase in profitability is primarily attributable to the Company's investment advisory fee and mutual fund administration fee increase due to an increase in AUM of \$1.3 billion year over year. This increase was partially offset by a significant decline in performance incentive fees due to investment performance not exceeding the minimum hurdle during the period.

**Revenue**

(in Thousands)	Nine Months Ended September 30,		% Change
	2007	2006	
Investment advisory	\$25,980	\$13,567	91%
Performance incentive	6	2,510	-100%
Mutual fund administration, net	4,439	2,407	84%
Total	\$30,425	\$18,484	65%

As a percent of 2007 year to date revenues, investment advisory fees account for 85%, performance incentive fees account for less than 1%, and mutual fund administration fees account for the remaining 15% compared to the 2006 period where investment advisory fees were 73%, performance incentive fees were 14%, and mutual fund administration fees were 13%.

**Investment Advisory Fees.** Investment advisory fees are calculated as a percent of average net assets under management at various levels depending on the investment product. The Company's average advisory fee rate for the nine months ended September 30, 2007 was 0.82% compared to 0.72% for the nine months ended September 30, 2006. This increase was mainly due to the increase in assets under management in the long-short products, which have a higher advisory fee. The overall increase in investment advisory fees was primarily due to an increase in AUM of \$1.3 billion year over year.

**Performance Incentive Fees.** Performance incentive fees are equal to 20% of the performance increase in client accounts after a 5% annual hurdle is achieved. The fees are dependent on both AUM and absolute investment performance in client accounts and will be volatile from period to period. Incentive fee AUM totaled \$622 million at September 30, 2007 compared to \$239 million at September 30, 2006. Incentive fees for the first nine months of 2007 were \$6 thousand which was down from \$2.5 million during the first nine months ended September 30, 2006. This decrease is due to investment performance not exceeding minimum hurdle for the nine months ended September 30, 2007.

**Mutual Fund Administration Fees.** Mutual fund administration fees are calculated as a percent of average net assets under administration in the Diamond Hill Funds. The Company earns 0.32% on Class A and Class C shares and 0.18% on Class I shares. As assets in the Funds have grown the Company has realized certain economies of scale; and as a result, the Company has lowered its administration fees by approximately 10% in each of the last two years to pass those economies of scale to fund shareholders. The Company lowered its administration fees again effective April 30, 2007 from 0.36% to 0.32% for Class A and Class C shares. Class I share fees remained unchanged at 0.18%. Despite lowering fees by approximately 10% on April 30, 2007 and 2006, fund administration revenues increased by \$2.0 million period over period.

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

(in Thousands)	Nine Months Ended September 30,		% Change
	2007	2006	
Compensation and related costs	\$14,948	\$10,638	41%
General and administrative	2,141	791	171%
Sales and marketing	349	219	59%
Third party distribution	1,128	327	245%
Mutual fund administration	1,817	1,187	53%
Total	\$20,383	\$13,162	55%

**Compensation and Related Costs.** Employee compensation and benefits increased by \$4.3 million, or 41%, during the nine months ended September 30, 2007 compared to nine months ended September 30, 2006. This increase is due to an increase in staff and incentive compensation, primarily on the investment team.

**General and Administrative.** General and administrative expenses increased by \$1.35 million, or 171%. The increase related to a trade error which resulted in a \$452,000 loss, additional investment research costs, additional rent expense associated with the larger office space the Company moved into during 2006, and other general expenses associated with the Company's growth.

**Sales and Marketing.** Sales and marketing expenses increased by \$130,000, or 59%. This increase was primarily due to increased travel related expenses incurred as a result of new business opportunities.

**Third Party Distribution.** Third party distribution expense represents payments made to intermediaries related to sales of the Company's investment products. The period over period increase directly corresponds to the increase in investment advisory fees earned by the Company.

**Mutual Fund Administration.** Mutual fund administration expense increased by \$629,000. A large portion of mutual fund administration expense is calculated based on a percent of assets under administration in the Diamond Hill Funds. The period over period increase is consistent with the continued growth in assets under administration.

**Liquidity and Capital Resources**

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

As of September 30, 2007, the Company had working capital of approximately \$32.1 million compared to \$19.1 million at December 31, 2006. 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 the remainder of 2007.

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. Management and the board believe that the most appropriate use for excess cash is to invest in Diamond Hill investment strategies or repurchase the Company's common stock. The deciding factor will be which alternative offers the most favorable risk-adjusted rate of return in the opinion of management and the board.

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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 Form 10-K Annual Report for 2006.

**ITEM 4: Controls and Procedures**

Management, including the Chief Executive Officer and the Chief Financial Officer, has conducted an evaluation of the effectiveness of disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based on the evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the disclosure controls and procedures are effective in ensuring that all material information required to be filed in this quarterly report has been made known to them in a timely fashion. There have been no significant changes in internal controls over financial reporting during the most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

**PART II: OTHER INFORMATION****ITEM 1: Legal Proceedings** None**ITEM 1A: Risk Factors**

There has been no material change to the information provided in Item 1A of the Form 10-K Annual Report for 2006.

**ITEM 2: Unregistered Sales of Equity Securities and use of Proceeds**

The following table sets forth information regarding the Company's purchases of its common stock during the third quarter of fiscal 2007:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Cumulative Number of Shares Purchased as part of a Publicly Announced Plan	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (1)
July 1, 2007 through July 31, 2007				
August 1, 2007 through August 31, 2007	1,398	\$ 72.92	1,398	348,602
September 1, 2007 through September 30, 2007				348,602

(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.

**ITEM 3: Defaults Upon Senior Securities** None

**ITEM 4: Submission of Matters to a Vote of Security Holders** None

**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
November 5, 2007	President, Chief Executive Officer, and a Director	/s/R. H. Dillon R. H. Dillon
November 5, 2007	Chief Financial Officer, Treasurer, and Secretary	/s/James F. Laird James F. Laird