

DIAMOND HILL INVESTMENT GROUP INC

Form 10-Q

May 09, 2008

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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 March 31, 2008
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 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. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting

(Do not check if a smaller

company

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 the latest practicable date, May 6, 2008, is 2,373,497 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**

| | 3/31/2008 (Unaudited) | 12/31/2007 |
|---|--------------------------|---------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 12,296,073 | \$ 11,783,278 |
| Investment portfolio | 33,535,286 | 34,036,163 |
| Accounts receivable | 6,382,927 | 5,694,274 |
| Prepaid expenses | 1,060,029 | 1,115,728 |
| Fixed assets, net of depreciation | 810,537 | 654,500 |
| | | |
| Total assets | \$ 54,084,852 | \$ 53,283,943 |
| | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Liabilities | | |
| Accounts payable and accrued expenses | 1,338,266 | \$ 979,467 |
| Accrued incentive compensation | 3,270,000 | 12,450,000 |
| Current and deferred taxes | 685,231 | 546,944 |
| | | |
| Total liabilities | 5,293,497 | 13,976,411 |
| | | |
| Commitments and contingencies | | |
| | | |
| Shareholders' Equity | | |
| Common stock, no par value | | |
| 7,000,000 shares authorized; | | |
| 2,370,810 issued and outstanding at March 31, 2008 | | |
| 2,243,653 issued and outstanding at December 31, 2007 | 36,484,073 | 27,719,024 |
| Preferred stock, undesignated, 1,000,000 shares authorized and unissued | | |
| Deferred compensation | (5,322,930) | (4,056,015) |
| Retained earnings | 17,630,212 | 15,644,523 |
| | | |
| Total shareholders' equity | 48,791,355 | 39,307,532 |
| | | |
| Total liabilities and shareholders' equity | \$ 54,084,852 | \$ 53,283,943 |

See notes to consolidated financial statements.

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

| | Three Months Ended March 31, | |
|-------------------------------------|------------------------------|---------------------|
| | 2008 | 2007 |
| REVENUES: | | |
| Investment advisory | \$ 9,231,995 | \$ 7,881,405 |
| Performance incentive | 280,900 | 4,297 |
| Mutual fund administration, net | 1,390,329 | 1,469,041 |
| | | |
| Total revenue | 10,903,224 | 9,354,743 |
| | | |
| OPERATING EXPENSES: | | |
| Compensation and related costs | 5,841,754 | 4,667,463 |
| General and administrative | 557,148 | 566,412 |
| Sales and marketing | 114,030 | 101,494 |
| Third party distribution | 396,105 | 379,334 |
| Mutual fund administration | 468,615 | 552,974 |
| | | |
| Total operating expenses | 7,377,652 | 6,267,677 |
| | | |
| NET OPERATING INCOME | 3,525,572 | 3,087,066 |
| | | |
| Investment return | (374,664) | (30,460) |
| | | |
| INCOME BEFORE TAXES | 3,150,908 | 3,056,606 |
| | | |
| Income tax provision | (1,165,219) | (1,062,193) |
| | | |
| NET INCOME | \$ 1,985,689 | \$ 1,994,413 |
| | | |
| Earnings per share | | |
| Basic | \$ 0.85 | \$ 0.98 |
| Diluted | \$ 0.82 | \$ 0.91 |
| | | |
| Weighted average shares outstanding | | |
| Basic | 2,337,706 | 2,029,958 |
| Diluted | 2,426,400 | 2,195,772 |

See notes to consolidated financial statements.

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

| | Three Months Ended March 31, | |
|---|------------------------------|--------------|
| | 2008 | 2007 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net Income | \$ 1,985,689 | \$ 1,994,413 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation on furniture and equipment | 38,465 | 27,140 |
| Amortization of deferred compensation | 559,538 | 228,026 |
| (Increase) decrease in accounts receivable | (688,653) | 1,676,080 |
| Increase in deferred taxes | 1,091,993 | 1,062,193 |
| Stock option expense | 1,340 | 3,015 |
| Change in unrealized gains/losses | 834,487 | 155,820 |
| (Decrease) in accrued liabilities | (2,993,296) | (5,858,722) |
| Other changes in assets and liabilities | 55,699 | (270,480) |
| Net cash provided by (used in) operating activities | 885,262 | (982,515) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (194,502) | (117,742) |
| Investment portfolio activity | (333,610) | (38,100) |
| Net cash used in investing activities | (528,112) | (155,842) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payment for repurchase of common shares | (116,896) | |
| Payment of taxes withheld on option/warrant exercises | (131,800) | (7,675,676) |
| Proceeds from common stock issuance | 404,341 | 3,228,064 |
| Purchase of treasury stock | | (1,342,148) |
| Sale of treasury stock | | 1,321,862 |
| Net cash provided by (used in) financing activities | 155,645 | (4,467,898) |
| CASH AND CASH EQUIVALENTS | | |
| Net change during the period | 512,795 | (5,606,255) |
| At beginning of period | 11,783,278 | 9,836,989 |
| At end of period | \$ 12,296,073 | \$ 4,230,734 |
| Cash paid during the period for: | | |
| Interest | | |
| Income taxes | | |
| Noncash Transactions during the period for: | | |

| | | |
|---|-----------|-----------|
| Common Stock Issued as Incentive Compensation | 5,754,140 | 5,478,718 |
| 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 four operating subsidiaries.

Diamond Hill Capital Management, Inc. (DHCM), an Ohio corporation, is a wholly owned subsidiary of the Company and a registered investment advisor. 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 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. Diamond Hill GP (Cayman) Ltd. 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 will provide certain fund administration services to small to mid size mutual funds. BHIL Distributors, Inc. (BHIL), an Ohio corporation, is a wholly owned subsidiary of BHFS incorporated on February 19, 2008. BHIL will provide distribution services to small to mid size mutual funds. BHIL had no operating activity during the first quarter of 2008.

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:

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

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 principally in one business segment, namely as an investment adviser and administrator to mutual funds, separate accounts, and private investment funds.

Cash and Cash Equivalents

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

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

Accounts Receivable

Accounts receivable are recorded when they are due and are presented in the balance sheet, net of any allowance for doubtful accounts. Accounts receivable are written off when they are determined to be uncollectible. Any allowance for doubtful accounts is estimated based on the Company's historical losses, existing conditions in the industry, and the financial stability of those individuals or entities that owe the receivable. No allowance for doubtful accounts was deemed necessary at March 31, 2008 or December 31, 2007.

Valuation of Investment Portfolio

Under Statement of Financial Accounting Standards (SFAS) No. 157 Fair Value Measurements (SFAS 157), all investments held by the Company are valued based upon the definition of Level 1 inputs. In general, SFAS 157 defines Level 1 inputs, as fair values which use quoted prices in active markets for identical assets or liabilities that the Company has the ability to access.

Investments in mutual funds are valued at their quoted closing current net asset values, or NAVs, per share of each mutual fund. Investments in Private Funds and other equity securities are independently valued based on readily available market quotations. The changes in market values 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 in its role as the managing member of the General Partner exerts significant influence over the financial and operating policies of DHIP and DHIP II but does not exercise control. Therefore, 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 board members, officers and employees of the Company invest in DHIP and DHIP II through Diamond Hill General Partner, LLC. These individuals receive no remuneration as a result of their personal investment in 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, 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 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 Performance Incentive Revenue**

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 Method 1, in which incentive fees are recorded at the end of the contract period for the specific client in which the incentive fee applies. The table below shows assets under management (AUM) subject to performance incentive fees and the performance incentive fees as calculated under each of the above methods:

| | As Of March 31, | |
|---|-----------------------|-----------------------|
| | 2008 | 2007 |
| AUM Contractual Period Ends Quarterly | \$ 284,542,311 | \$ 270,989,720 |
| AUM Contractual Period Ends Annually | 376,395,460 | 249,440,743 |
| Total AUM Subject to Performance Incentive | \$ 660,937,771 | \$ 520,430,463 |

| | For The Period Ending March 31, | |
|-------------------------------------|---------------------------------|----------|
| | 2008 | 2007 |
| Performance Incentive Fees Method 1 | \$280,900 | \$ 4,297 |
| Performance Incentive Fees Method 2 | \$280,900 | 39,530 |

Amounts under Method 1 and Method 2 may differ throughout the year, but will generally be the same at fiscal year end because all client account contract periods end on December 31.

Revenue Recognition Mutual Fund Administration

DHCM has an administrative, fund accounting and transfer agency services agreement with the Diamond Hill Funds (Funds), under which DHCM performs certain services for each fund. These services include mutual fund administration, accounting, transfer agency and other related functions. For performing these services, each fund 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, the fee for administrative services was reduced from 0.36% to 0.32% for Class A and Class C shares. The Funds have selected and contractually engaged certain vendors to fulfill various services to benefit the Funds' shareholders or to satisfy regulatory requirements of the Funds. These services include, among others, required fund shareholder mailings, registration fees, legal and audit fees. 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. Consistent with EITF 99-19, revenue has been recorded net of these Fund expenses. In addition, DHCM finances the up-front commissions which are paid by the Fund's principal underwriter to brokers who sell 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 re-payments DHCM receives from the principal underwriter to recoup this commission advancement. Mutual fund administration (admin) gross and net revenue are summarized below:

Table of ContentsNote 2 Significant Accounting Policies (Continued)Revenue Recognition – Mutual Fund Administration (Continued)

| | Three Months Ended March 31, | |
|---|------------------------------|--------------|
| | 2008 | 2007 |
| Mutual fund admin revenue, gross | \$ 2,044,549 | \$ 2,036,346 |
| Mutual fund admin, fund related expense | 661,038 | 576,821 |
| Mutual fund admin revenue, net of fund related expenses | 1,383,511 | 1,459,525 |
| C-Share broker commission advance repayments | 398,947 | 412,200 |
| C-Share broker commission amortization | 392,129 | 402,684 |
| C-Share financing activity, net | 6,818 | 9,516 |
| Mutual fund administration revenue, net | \$ 1,390,329 | \$ 1,469,041 |

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 firm. 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 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.

Reclassifications

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

Table of ContentsNote 3 Investment Portfolio

As of March 31, 2008, the Company held investments worth \$33.5 million and a cost basis of \$31.7 million. The following table summarizes the market value of these investments as of March 31, 2008 and December 31, 2007:

| | March 31, 2008 | December 31, 2007 |
|---|----------------------|----------------------|
| Diamond Hill Small Cap Fund | \$ 1,021,094 | \$ 1,039,517 |
| Diamond Hill Small-Mid Cap Fund | 986,239 | 1,016,243 |
| Diamond Hill Large Cap Fund | 951,765 | 1,017,340 |
| Diamond Hill Select Fund | 939,066 | 1,015,803 |
| Diamond Hill Long-Short Fund | 1,023,162 | 1,027,615 |
| Diamond Hill Financial Long-Short Fund | 937,270 | 1,025,356 |
| Diamond Hill Strategic Income Fund | 3,760,053 | 3,765,566 |
| Diamond Hill Investment Partners, L.P. | 10,104,219 | 10,070,021 |
| Diamond Hill Investment Partners II, L.P. | 5,079,496 | 5,058,702 |
| Other marketable equity securities | 8,732,922 | 9,000,000 |
| Total Investment Portfolio | \$ 33,535,286 | \$ 34,036,163 |

DHCM is the managing member of the Diamond Hill General Partner LLC, which is the General Partner of DHIP and DHIP II. The underlying assets of DHIP and DHIP II are cash and marketable equity securities whose values are determined based on independent readily available market quotations. The Company, as the parent entity to DHCM, is not contingently liable for the partnership's liabilities but rather is only liable for its proportionate share, based on its membership interest. DHCM, as the managing member of the General Partner, is also not contingently liable for the partnership's liabilities. Summary financial information, including the Company's carrying value and income from these partnerships is as follows:

| | March 31, 2008 | December 31, 2007 |
|-------------------------------|-------------------|----------------------|
| Total partnership assets | \$ 340,939,106 | \$ 360,372,685 |
| Total partnership liabilities | 58,903,561 | 80,007,267 |
| Net partnership assets | 282,035,545 | 280,365,418 |
| Net partnership income (loss) | (278,237) | 6,581,829 |
| DHCM's portion of net assets | 15,183,714 | 15,128,723 |
| DHCM's portion of net income | 54,992 | 562,469 |

While the partnerships experienced in total a net loss during the current quarter ended March 31, 2008, DHCM's portion of net income was positive due to DHCM's exclusion from paying a management fee. DHCM's income from these partnerships includes its pro-rata capital allocation and its share of an incentive allocation, if any, 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 March 31, 2008 or December 31, 2007.

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 March 31, 2008 shares available for issuance under the Plan are 498,506. 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 provides 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.

These grants, along with other restricted stock grants which vest over time, are recorded as deferred compensation on grant date and then recognized as compensation expense over the vesting period of the respective grant.

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 March 31, 2008 and 2007, expenses attributable to the plan were \$138,342 and \$100,985, respectively.

Table of Contents**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.

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, 2006 | 283,102 | \$ 14.60 | 249,400 | \$ 12.57 |
| Exercisable December 31, 2006 | 243,102 | \$ 16.26 | 249,400 | \$ 12.57 |
| Granted | | | | |
| Expired / Forfeited | | | 2,000 | 10.63 |
| Exercised | 114,002 | 20.29 | 222,000 | 8.65 |
| Outstanding March 31, 2007 | 169,100 | \$ 10.76 | 25,400 | \$ 47.00 |
| Exercisable March 31, 2007 | 129,100 | \$ 12.70 | 25,400 | \$ 47.00 |
| Outstanding December 31, 2007 | 92,500 | \$ 10.40 | 25,400 | \$ 47.00 |
| Exercisable December 31, 2007 | 72,500 | \$ 12.03 | 25,400 | \$ 47.00 |
| Granted | | | | |
| Expired / Forfeited | | | | |
| Exercised | 17,500 | 11.81 | 1,000 | 22.50 |
| Outstanding March 31, 2008 | 75,000 | \$ 10.08 | 24,400 | \$ 48.07 |
| Exercisable March 31, 2008 | 55,000 | \$ 12.10 | 24,400 | \$ 48.07 |

The Company withheld from issuing 81,833 of the 336,002 and 352 of the 18,500 shares of warrants and options exercised during the quarters ended March 31, 2007 and March 31, 2008, respectively. These shares were withheld to fulfill tax withholding requirements related to employee compensation earned on the exercises.

Options and warrants outstanding and exercisable at March 31, 2008 are as follows:

| Number | Options | | | Exercise Price | Warrants | | | Exercise Price |
|-------------|----------------|-------------|-------------|----------------|----------------|-------------|-------------|----------------|
| | Remaining Life | Number | Exercisable | | Remaining Life | Number | Exercisable | |
| Outstanding | In Years | Exercisable | | Outstanding | In Years | Exercisable | | |
| 10,000 | 2.36 | 10,000 | \$ 7.95 | 14,000 | 0.12 | 14,000 | \$ 73.75 | |
| 5,500 | 2.72 | 5,500 | 8.44 | 400 | 0.75 | 400 | 22.20 | |

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| | | | | | | | |
|--------|------|--------|-------|--------|------|--------|-------|
| 14,500 | 2.72 | 14,500 | 28.10 | 2,000 | 1.12 | 2,000 | 22.50 |
| 5,000 | 3.01 | 5,000 | 8.45 | 6,000 | 1.92 | 6,000 | 11.25 |
| 40,000 | 5.18 | 20,000 | 4.50 | 2,000 | 2.11 | 2,000 | 8.75 |
| 75,000 | 4.01 | 55,000 | | 24,400 | 0.81 | 24,400 | |

The aggregate intrinsic value of options/warrants outstanding and exercisable as of March 31, 2008 are:

Outstanding \$ 5,678,108

Exercisable \$ 4,237,908

Table of Contents**Note 6 Operating Leases**

The Company leases approximately 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. In addition, the Company leases approximately 2,239 square feet of office space at 4041 N. High Street, Suite 402, Columbus, Ohio 43214 under an operating lease agreement which terminates on February 13, 2011. Total lease and operating expenses for the three months ended March 31, 2008 and 2007 were \$93,961 and \$68,549, respectively. The approximate future minimum lease payments under the operating lease are as follows:

| 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|-----------|-----------|-----------|-----------|-----------|-----------|
| \$187,000 | \$259,000 | \$267,000 | \$249,000 | \$254,000 | \$130,000 |

In addition to the above rent, the Company will also be responsible for normal operating expenses of the properties. Such operating expenses were approximately \$9.04 per square foot in 2007, which only included the 325 John H. McConnell Blvd. location, and are expected to be approximately \$8.90 per square foot in 2008 on a combined basis.

Note 7 Income Taxes

The provision for income taxes for the three months ended March 31, 2008 and 2007 consists of federal and city income taxes.

Tax Impact of Stock Option and Warrant Exercises

The exercise of stock options and warrants during 2007 and through the three months ended March 31, 2008 resulted in a cumulative federal tax deduction of \$22.8 million, and a corresponding federal tax benefit of \$7.8 million. In accordance with GAAP, this tax benefit is not reflected in the consolidated statements of income or in earnings per share. \$5.8 million and \$1.0 million, of this \$7.8 million federal tax benefit has been recorded as a reduction of federal taxes payable in 2007 and the three months ended March 31, 2008, respectively, and as a corresponding increase in shareholders equity.

Note 8 Earnings Per Share

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

| | Three Months Ended March 31, | |
|---|------------------------------|--------------|
| | 2008 | 2007 |
| Basic and Diluted net income | \$ 1,985,689 | \$ 1,994,413 |
| Weighted average number of outstanding shares | | |
| Basic | 2,337,706 | 2,029,958 |
| Diluted | 2,426,400 | 2,195,772 |
| Earnings per share | | |
| Basic | \$ 0.85 | \$ 0.98 |
| Diluted | \$ 0.82 | \$ 0.91 |

The diluted EPS calculation excludes the effect of stock options when their exercise prices exceed the average market price for the period.

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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 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 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. During the first quarter of 2008, the Company incorporated two new subsidiaries, Beacon Hill Fund Services, Inc. ("BHFS") and BHIL Distributors, Inc. ("BHIL") to collectively operate as ("Beacon Hill"). Beacon Hill will provide certain fund administration services and distribution services to small to mid size mutual funds, including Diamond Hill Funds.

In this section, the company discusses and analyzes the consolidated results of operations for the three month periods ending March 31, 2008 and 2007 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 generally 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 March 31, 2008, assets under management (AUM) totaled \$4.7 billion, a 12% increase in comparison to March 31, 2007. Revenues are highly dependant on both the value and composition of AUM. The following is a summary of the firm's AUM by product and objective as of March 31, 2008 and 2007 and a roll-forward of AUM growth for the three months ended March 31, 2008 and 2007:

| (in millions) | Assets Under Management by Product As of March 31, | | |
|--------------------------|---|----------------|---------------------|
| | 2008 | 2007 | % Change |
| Mutual funds | \$3,152 | \$2,829 | 11% |
| Separate accounts | 1,032 | 923 | 12% |
| Private investment funds | 481 | 417 | 15% |
| Total | \$4,665 | \$4,169 | 12% |

| (in millions) | Assets Under Management by Objective As of March 31, | | |
|----------------------------|---|----------------|---------------------|
| | 2008 | 2007 | % Change |
| Small and Small-Mid Cap | \$ 566 | \$ 762 | -26% |
| Large Cap and Select | 1,036 | 980 | 6% |
| Long-Short | 2,799 | 2,137 | 31% |
| Strategic and fixed income | 264 | 290 | -9% |
| Total | \$4,665 | \$4,169 | 12% |

| (in millions) | Growth in Assets Under Management For the Three Months Ended March 31, | |
|------------------------------------|---|-------------|
| | 2008 | 2007 |
| AUM at beginning of the period | \$ 4,403 | \$ 3,708 |
| Net cash inflows (outflows) | | |
| mutual funds | 309 | 356 |
| separate accounts | 74 | 21 |
| private investment funds | (13) | 110 |
| | 370 | 487 |
| Net market appreciation and income | (108) | (26) |
| Increase during the period | 262 | 461 |
| AUM at end of the period | \$ 4,665 | \$ 4,169 |

Consolidated Results of Operations

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

| | Three Months Ended March 31, | | % Change |
|--|------------------------------|---------|-------------|
| | 2008 | 2007 | |
| Net income (in thousands) | \$1,986 | \$1,994 | 0% |
| Net income per share | | | |
| Basic | \$ 0.85 | \$ 0.98 | -13% |
| Diluted | \$ 0.82 | \$ 0.91 | -10% |
| Weighted average shares outstanding (in thousands) | | | |
| Basic | 2,338 | 2,030 | |
| Diluted | 2,426 | 2,196 | |

Table of Contents**Three Months Ended March 31, 2008 compared with Three Months Ended March 31, 2007**

The Company generated net income of \$1,985,689 (\$0.82 per diluted share) for the three months ended March 31 2008, compared with net income of \$1,994,413 (\$0.91 per diluted share) for the three months ended March 31, 2007. The decrease in earnings per share was due to the issuance of additional shares from the Company's equity incentive plans. Net income was flat despite a 12% increase in AUM primarily due to a negative return on the Company's corporate investment portfolio, a full quarter effect of lowering administration fees on the Diamond Hill Funds by four basis points, and the loss from Beacon Hill of approximately \$191,000 as it starts up its operation.

Revenue

| (in Thousands) | Three Months Ended March 31, | | % Change |
|---------------------------------|---------------------------------|---------|-------------|
| | 2008 | 2007 | |
| Investment advisory | \$ 9,232 | \$7,882 | 17% |
| Performance incentive | 281 | 4 | n.m. |
| Mutual fund administration, net | 1,390 | 1,469 | -5% |
| Total | \$10,903 | \$9,355 | 17% |

As a percent of total first quarter 2008 revenues, investment advisory fees accounted for 85%, performance incentive fees accounted for less than 3%, and mutual fund administration fees accounted for the remaining 13% compared to the first quarter of 2007 where investment advisory fees accounted for 84%, performance incentive fees accounted for less than 1%, and mutual fund administration fees accounted for 16% 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 March 31, 2008 was 0.82% compared to 0.80% for the three months ended March 31, 2007. 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 \$500 million quarter over quarter.

Performance Incentive Fees. Performance incentive fees are generally 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 \$661 million at March 31, 2008 compared to \$520 million at March 31, 2007. Incentive fees increased during the first quarter of 2008 compared to 2007 due to investment performance exceeding the minimum hurdle in certain accounts for the three months ended March 31, 2008 and not exceeding the hurdle for the three months ended March 31, 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 three years to pass on those economies of scale to fund shareholders. The Company lowered its administration fees again effective April 30, 2008 from 0.32% to 0.30% for Class A and Class C shares. Class I share fees remained unchanged at 0.18%. As a result of lowering fees by approximately 10% on April 30, 2007, fund administration revenues decreased by \$79,000 for the quarter ended March 31, 2008 compared to March 31, 2007, despite the increase in mutual fund AUM of \$323 million.

Table of Contents**Expenses**

| (in Thousands) | Three Months Ended March 31, | | % Change |
|--------------------------------|---------------------------------|----------------|-------------|
| | 2008 | 2007 | |
| Compensation and related costs | \$5,842 | \$4,668 | 25% |
| General and administrative | 557 | 566 | -2% |
| Sales and marketing | 114 | 102 | 12% |
| Third party distribution | 396 | 379 | 4% |
| Mutual fund administration | 469 | 553 | -15% |
| Total | \$7,378 | \$6,268 | 18% |

Compensation and Related Costs. Employee compensation and benefits increased by \$1.2 million, or 25%, during the three months ended March 31, 2008 compared to the three months ended March 31, 2007. This increase is due to an increase in staff and long-term equity awards.

General and Administrative. General and administrative expenses decreased by \$9,000 or 2%. General and administrative expenses have remained relatively stable quarter over quarter, as the Company has not experienced a significant increase in research and other related operating expenses.

Sales and Marketing. Sales and marketing expenses increased by \$12,000 or 12%. This increase was primarily due to an increase in travel and other marketing expenses related to new business growth.

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 decreased by \$84,000 or 15%. This decrease is attributable to a re-negotiation of certain vendor contracts resulting in both expense reductions and a shifting of certain expense obligations directly to the Diamond Hill Funds. Absent this contract re-negotiation, mutual fund administration expenses generally correlate with an increase or decrease in mutual fund 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 and other equity securities are valued based on readily available market quotations. Inflation is expected to have no material impact on the Company's performance.

As of March 31, 2008, the Company had working capital of approximately \$46.9 million compared to \$37.5 million at December 31, 2007. 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 2008.

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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Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements with any obligation under a guarantee contract, or a retained or contingent interest in assets or similar arrangement that serves as credit, liquidity or market risk support for such assets, or any other obligation, including a contingent obligation, under a contract that would be accounted for as a derivative instrument or arising out of a variable interest.

Critical Accounting Policies and Estimates

There have been no material changes to the Critical Accounting Policies and Estimates provided in Item 7 of the Form 10-K Annual Report for 2007.

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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 2007.

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 not been any changes in the Company's internal control over financial reporting 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 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 2007.

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 first quarter of fiscal 2008:

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as part of a Publicly Announced Plans or Programs | Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (1) |
|--|----------------------------------|------------------------------|--|--|
| January 1, 2008 through January 31, 2008 | 1,586 | 73.71 | 6,528 | 343,472 |
| February 1, 2008 through February 29, 2008 | | | 6,528 | 343,472 |
| March 1, 2008 through March 31, 2008 | | | 6,528 | 343,472 |

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

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ITEM 3: Defaults Upon Senior Securities None

ITEM 4: 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 |
|-------------|---|-------------------------------------|
| May 9, 2008 | President, Chief Executive Officer, and a Director | /s/R. H. Dillon R. H. Dillon |
| May 9, 2008 | Chief Financial Officer, Treasurer, and Secretary | /s/James F. Laird James F. Laird |