

DIAMOND HILL INVESTMENT GROUP INC

Form 10-Q

August 02, 2013

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United States
Securities and Exchange Commission

Washington, D.C. 20549

Form 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2013

Commission file number 000-24498

DIAMOND HILL INVESTMENT GROUP, INC.

(Exact name of registrant as specified in its charter)

Ohio
(State of

65-0190407
(I.R.S. Employer

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incorporation)

Identification No.)

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

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

(614) 255-3333

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes: No:

The number of shares outstanding of the issuer's common stock, as of July 26, 2013, is 3,260,283 shares.

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

| | 6/30/2013 (Unaudited) | 12/31/2012 |
|---|--------------------------|----------------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 12,849,477 | \$ 7,870,908 |
| Investment portfolio | 21,148,293 | 16,503,731 |
| Accounts receivable | 11,629,694 | 10,438,598 |
| Prepaid expenses | 937,954 | 953,526 |
| Furniture and equipment, net of depreciation | 914,372 | 745,476 |
| Income tax receivable | 1,644,356 | 2,271,704 |
| Deferred taxes | 3,814,149 | 2,451,974 |
| Total assets | \$ 52,938,295 | \$ 41,235,917 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Liabilities | | |
| Accounts payable and accrued expenses | \$ 2,365,751 | \$ 2,797,483 |
| Accrued incentive compensation | 10,348,714 | 15,908,083 |
| Deferred compensation liability | 894,678 | 794,644 |
| Total liabilities | 13,609,143 | 19,500,210 |
| Commitments and contingencies | | |
| Shareholders' Equity | | |
| Common stock, no par value | | |
| 7,000,000 shares authorized; | | |
| 3,261,594 issued and outstanding at June 30, 2013 | | |
| (inclusive of 342,139 unvested shares); | | |
| 3,169,987 issued and outstanding at December 31, 2012 | | |
| (inclusive of 319,988 unvested shares) | 72,439,252 | 65,255,813 |
| Preferred stock, undesignated, 1,000,000 shares authorized and unissued | | |
| Deferred equity compensation | (14,461,741) | (14,829,470) |
| Accumulated deficit | (18,648,359) | (28,690,636) |
| Total shareholders' equity | 39,329,152 | 21,735,707 |
| Total liabilities and shareholders' equity | \$ 52,938,295 | \$ 41,235,917 |
| Book value per share | \$ 12.06 | \$ 6.86 |

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

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------------------------|-----------------------------|---------------|---------------------------|---------------|
| | 2013 | 2012 | 2013 | 2012 |
| REVENUES: | | | | |
| Investment advisory | \$ 17,090,321 | \$ 14,101,053 | \$ 32,944,314 | \$ 28,476,147 |
| Mutual fund administration, net | 2,802,775 | 2,059,802 | 5,304,956 | 4,298,928 |
| Total revenue | 19,893,096 | 16,160,855 | 38,249,270 | 32,775,075 |
| OPERATING EXPENSES: | | | | |
| Compensation and related costs | 10,357,680 | 8,378,703 | 19,871,092 | 16,866,212 |
| General and administrative | 1,421,116 | 1,184,453 | 2,813,584 | 2,402,544 |
| Sales and marketing | 384,548 | 246,924 | 652,192 | 475,850 |
| Third party distribution | 157,963 | 138,298 | 305,406 | 351,706 |
| Mutual fund administration | 420,098 | 381,949 | 827,691 | 827,695 |
| Total operating expenses | 12,741,405 | 10,330,327 | 24,469,965 | 20,924,007 |
| NET OPERATING INCOME | 7,151,691 | 5,830,528 | 13,779,305 | 11,851,068 |
| Investment income (loss) | 728,725 | (468,432) | 2,553,384 | 803,299 |
| INCOME BEFORE TAXES | 7,880,416 | 5,362,096 | 16,332,689 | 12,654,367 |
| Income tax provision | (3,168,871) | (2,033,999) | (6,290,412) | (4,714,917) |
| NET INCOME | \$ 4,711,545 | \$ 3,328,097 | \$ 10,042,277 | \$ 7,939,450 |
| Earnings per share | \$ 1.45 | \$ 1.07 | \$ 3.12 | \$ 2.59 |
| Weighted average shares outstanding | 3,248,197 | 3,101,170 | 3,222,977 | 3,066,002 |

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

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

| | Six Months Ended June 30, | |
|---|---------------------------|----------------------|
| | 2013 | 2012 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net Income | \$ 10,042,277 | \$ 7,939,450 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation on furniture and equipment | 165,533 | 162,177 |
| Stock-based compensation | 3,006,652 | 2,673,534 |
| (Increase) decrease in accounts receivable | (1,191,096) | 425,914 |
| Change in deferred income taxes | (1,366,935) | (246,121) |
| Investment (gain)/loss, net | (2,644,562) | (789,799) |
| Decrease in accrued compensation | (853,327) | (2,865,625) |
| Excess income tax benefit from stock-based compensation | | (29,029) |
| Decrease in accrued liabilities | (431,732) | (605,689) |
| Other changes in assets and liabilities | 642,920 | (379,716) |
| Net cash provided by operating activities | 7,369,730 | 6,285,096 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of furniture and equipment | (334,429) | (55,867) |
| Cost of investments purchased and other portfolio activity | (2,000,000) | (6,365,000) |
| Net cash used in investing activities | (2,334,429) | (6,420,867) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payment of taxes withheld on employee stock transactions | (56,732) | (363,925) |
| Excess income tax benefit from stock-based compensation | | 29,029 |
| Net cash used in financing activities | (56,732) | (334,896) |
| CASH AND CASH EQUIVALENTS | | |
| Net change during the period | 4,978,569 | (470,667) |
| At beginning of period | 7,870,908 | 15,242,768 |
| At end of period | \$ 12,849,477 | \$ 14,772,101 |
| Supplemental cash flow information: | | |
| Interest paid | \$ | \$ |
| Income taxes paid | 7,030,000 | 5,418,000 |
| Supplemental disclosure of non-cash transactions: | | |
| Common stock issued as incentive compensation | 4,606,008 | 5,540,792 |

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

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Diamond Hill Investment Group, Inc.

Notes to Consolidated Financial Statements (unaudited)

Note 1 Business and Organization

Diamond Hill Investment Group, Inc. (the Company), an Ohio Corporation, derives its consolidated revenues and net income primarily from investment advisory and fund administration services. The Company has three operating subsidiaries.

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

Beacon Hill Fund Services, Inc. (BHFS), an Ohio corporation, is a wholly owned subsidiary of the Company. BHFS provides certain compliance, treasury, and other fund administration services to mutual fund companies. BHIL Distributors, Inc. (BHIL), an Ohio corporation, is a wholly owned subsidiary of BHFS. BHIL provides underwriting to mutual funds. BHFS and BHIL collectively operate as Beacon Hill.

Note 2 Significant Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses for the periods. Actual results could differ from those estimates. Certain prior period amounts and disclosures have been reclassified to conform to the current period financial presentation. Book value per share is computed by dividing total shareholders' equity by the number of shares issued and outstanding at the end of the measurement period. The following is a summary of the Company's significant accounting policies:

Principles of Consolidation

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

Segment Information

Management has determined that the Company operates in one business segment, namely providing investment management and administration services to mutual funds, institutional accounts, and private investment funds. Therefore, no disclosures relating to operating segments are required in annual or interim financial statements.

Cash and Cash Equivalents

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

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

Accounts receivable are recorded when they are due and are presented in the balance sheet net of any allowance for doubtful accounts. Accounts receivable are written off when they are determined to be uncollectible. Any allowance for doubtful accounts is estimated based on the Company's historical losses, existing conditions in the industry, and the financial stability of those individuals or entities that owe the receivable. No allowance for doubtful accounts was deemed necessary at either June 30, 2013 or December 31, 2012.

Valuation of Investment Portfolio

Investments held by the Company are valued based upon the definition of Level 1 inputs and Level 2 inputs. Level 1 inputs are defined as fair values which use quoted prices in active markets for identical assets or liabilities. Level 2 inputs are defined as quoted prices in markets that are not considered to be active for identical assets or liabilities, quoted prices in active markets for similar assets or liabilities, and inputs other than quoted prices that are directly observable or that may be corroborated indirectly with observable market data. The following table summarizes the values of the Company's investments based upon Level 1 and Level 2 inputs as of June 30, 2013 and December 31, 2012:

| | June 30, 2013 | December 31, 2012 |
|----------------|---------------|-------------------|
| Level 1 Inputs | \$ 27,658,778 | \$ 16,922,720 |
| Level 2 Inputs | 3,991,509 | 3,650,561 |

Level 1 investments are all registered investment companies (mutual funds) and include \$10.5 million and \$4.1 million, respectively, of money market mutual funds that the Company classifies as cash equivalents. Level 2 investments are all limited partnerships. There were no transfers in or out of the levels.

The changes in market values on the investments are recorded in the Consolidated Statements of Income as investment income.

Limited Partnership Interests

DHCM is the managing member of Diamond Hill General Partner, LLC (the "General Partner"), the general partner of Diamond Hill Investment Partners, L.P. ("DHIP"), Diamond Hill Research Partners International, L.P. ("DHRPI"), and Diamond Hill Valuation-Weighted 500, L.P. ("DHVW") (collectively, the "Partnerships"), each a limited partnership whose underlying assets consist of marketable securities.

DHCM, in its role as managing member of the General Partner, has the power to direct each Partnership's economic activities and the right to receive investment advisory and performance incentive fees that may be significant to the Partnerships. The Company evaluated these Partnerships to determine whether or not to consolidate the entities in accordance with FASB ASC 810, Consolidation. Certain of these Partnerships are considered to be variable interest entities ("VIEs") while others are considered to be voting rights entities ("VREs"), both of which are subject to consolidation consideration. The Company would consolidate VIEs where the Company is considered the primary beneficiary or VREs where the General Partner is considered to control the Partnership. For the Partnerships that were considered VIEs, the Company was not deemed to be the primary beneficiary. For the Partnerships that were considered VREs, it was determined that the DHCM in its role of managing member of the General Partner did not control the Partnerships. Therefore, the investments are accounted for under the equity method rather than being consolidated in the accompanying financial statements.

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Note 2 Significant Accounting Policies (Continued)

Limited Partnership Interests (Continued)

DHCM's investments in these Partnerships are reported as a component of the Company's investment portfolio, valued at DHCM's proportionate interest in the net asset value of the marketable securities held by

the Partnerships. Gains and losses attributable to changes in the value of DHCM's interests in the Partnerships are included in the Company's reported investment income.

The Company's exposure to loss as a result of its involvement with the Partnerships is limited to the amount of its investments. DHCM is not obligated to provide financial or other support to the Partnerships, other than its investments to date and its contractually provided investment advisory responsibilities, and has not provided such support. The Company has not provided liquidity arrangements, guarantees or other commitments to support the Partnerships' operations, and the Partnerships' creditors and interest holders have no recourse to the general credit of the Company.

Certain board members, officers and employees of the Company invest in DHIP. These individuals receive no remuneration as a result of their personal investment in the Partnership. The capital of the General Partner 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.

Deferred Compensation Liability

Deferred compensation liability represents compensation that will be paid out upon satisfactory completion of certain performance-based criteria specified in employee award agreements issued pursuant to the 2011 Equity and Cash Incentive Plan. See Note 5.

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, generally calculated as a percentage of assets under management (AUM), 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 periodic variable incentive fees.

Revenue Recognition - Incentive Revenue

The Company manages certain client accounts that provide for variable incentive fees. These fees are based on investment results over rolling five year periods. For variable management fees based on a formula, there are two methods by which incentive revenue may be recorded. Under Method 1, incentive fees are recorded at the end of the contract measurement 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 measurement period for the specific client in which the incentive fee applies. The table below shows AUM subject to incentive fees and the incentive fees, as calculated under each of the above methods:

Table of ContentsNote 2 Significant Accounting Policies (Continued)Revenue Recognition – Incentive Revenue (Continued)

| | As Of June 30, | | | |
|---|-------------------------------------|----------------|-----------------------------------|------|
| | 2013 | 2012 | | |
| AUM Contractual Period Ends: | | | | |
| May 2017 | \$ 331,253,656 | \$ 254,288,524 | | |
| | For The Three Months Ended June 30, | | For The Six Months Ended June 30, | |
| | 2013 | 2012 | 2013 | 2012 |
| Incentive Fees Under Method 1 - Contractual Period Ends: | | | | |
| May 2017 | \$ | \$ | \$ | \$ |
| Incentive Fees Under Method 2 - Contractual Period Ends: | | | | |
| May 2017 | \$ 2,464,815 | \$ | \$ 2,464,815 | \$ |

Revenue Recognition – Mutual Fund Administration

DHCM has an administrative and transfer agency services agreement with the Funds, under which DHCM performs certain services for each fund. These services include mutual fund administration, transfer agency and other related functions. For performing these services, each Fund pays DHCM a fee, which is calculated using the following annual rates times the average daily net assets of each respective fund and share class:

| | Prior to February 29, 2012 | After February 29, 2012 |
|---------------------|-------------------------------|----------------------------|
| Class A and Class C | 0.26% | 0.25% |
| Class I | 0.24% | 0.25% |
| Class Y | 0.10% | 0.10% |

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 shareholder mailings, federal and state registrations, and legal and audit services. DHCM, in fulfilling a portion of its role under the administration agreement with the Funds, acts as agent to pay these obligations of the Funds. Each vendor is independently responsible for fulfillment of the services it has been engaged to provide and negotiates fees and terms with the management and board of trustees of the Funds. The fee that each Fund pays to DHCM is reviewed annually by the Funds' board of trustees and specifically takes into account the contractual expenses that DHCM pays on behalf of the Funds. As a result, DHCM is not involved in the delivery or pricing of these services and bears no risk related to these services. Revenue has been recorded net of these Fund related expenses, in accordance with FASB ASC 605-45, *Revenue Recognition – Principal Agent Considerations*. In addition, DHCM finances the upfront commissions which are paid to brokers who sell Class C shares of the Funds. As financier, DHCM advances the commission amount to be paid to the selling broker at the time of sale. These advances are capitalized and amortized over 12 months to correspond with the repayments DHCM receives from the principal underwriter to recoup this commission advancement.

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

Beacon Hill has underwriting and administrative service agreements with certain clients, including registered mutual funds. The fee arrangements vary from client to client based upon services provided and are recorded as revenue under mutual fund administration on the Consolidated Statements of Income. Part of Beacon Hill's role as underwriter is to act as an agent on behalf of its mutual fund clients to receive 12b-1/service fees and commission revenue and facilitate the payment of those fees and commissions to third parties who provide services to the funds and their shareholders. The amount of 12b-1/service fees and commissions are determined by each mutual fund client, and Beacon Hill bears no financial risk related to these services. As a result, 12b-1/service fees and commission revenue has been recorded net of the expense payments to third parties, in accordance with the appropriate accounting treatment for this agency relationship.

Mutual fund administration gross and net revenue are summarized below:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|---------------------|---------------------------|---------------------|
| | 2013 | 2012 | 2013 | 2012 |
| Mutual fund administration: | | | | |
| Administration revenue, gross | \$ 4,015,154 | \$ 3,216,646 | \$ 7,630,884 | \$ 6,326,505 |
| 12b-1/service fees and commission revenue received from fund clients | 1,984,681 | 1,705,001 | 3,797,068 | 3,434,353 |
| 12b-1/service fees and commission expense payments to third parties | (1,738,197) | (1,435,822) | (3,327,009) | (2,794,067) |
| Fund related expense | (1,460,656) | (1,430,653) | (2,800,429) | (2,673,655) |
| Revenue, net of fund related expenses | 2,800,982 | 2,055,172 | 5,300,514 | 4,293,136 |
| DHCM C-Share financing: | | | | |
| Broker commission advance repayments | 64,674 | 58,262 | 121,332 | 120,670 |
| Broker commission amortization | (62,881) | (53,632) | (116,890) | (114,878) |
| Financing activity, net | 1,793 | 4,630 | 4,442 | 5,792 |
| Mutual fund administration revenue, net | \$ 2,802,775 | \$ 2,059,802 | \$ 5,304,956 | \$ 4,298,928 |

Third Party Distribution Expense

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

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

The Company accounts for income taxes through an asset and liability approach. Deferred taxes are provided on an asset and liability method, whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Deferred tax assets are reduced by a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Company is subject to examination by various federal, state and local jurisdictions for various tax periods. The Company's income tax positions are based on research and interpretations of the income tax laws and rulings in each of the jurisdictions in which the Company does business. Due to the subjectivity of interpretations of laws and rulings in each jurisdiction, the differences and interplay in tax laws between those jurisdictions, as well as the inherent uncertainty in estimating the final resolution of complex tax audit matters, the Company's estimates of income tax liabilities may differ from actual payments or assessments. The Company regularly assesses its position with regard to tax exposures and records liabilities for these uncertain tax positions and related interest and penalties, if any, according to the principles of FASB ASC 740, *Income Taxes*. As of June 30, 2013, the Company has not recorded any liability for uncertain tax positions.

Earnings Per Share

Earnings per share (EPS) is computed by dividing net income by the weighted average number of Common Shares outstanding for the period. For the periods presented, the Company has unvested stock-based payment awards that contain nonforfeitable rights to dividends. For the periods presented, the Company does not have dilutive securities outstanding.

Note 3 Investment Portfolio

As of June 30, 2013, the Company held investments (excluding money market funds, which are included with cash and cash equivalents) worth \$21.1 million with an estimated cost basis of \$14.4 million. The following table summarizes the market value of these investments:

| | June 30, 2013 | December 31, 2012 |
|--|-------------------|----------------------|
| Diamond Hill Small Cap Fund | \$ 260,457 | \$ 215,550 |
| Diamond Hill Small-Mid Cap Fund | 290,443 | 239,316 |
| Diamond Hill Large Cap Fund | 292,526 | 246,744 |
| Diamond Hill Select Fund | 298,925 | 242,252 |
| Diamond Hill Long-Short Fund | 1,166,467 | 1,036,045 |
| Diamond Hill Financial Long-Short Fund | 1,969,770 | |
| Diamond Hill Research Opportunities Fund | 12,667,255 | 10,658,665 |
| Diamond Hill Strategic Income Fund | 210,941 | 214,598 |
| Diamond Hill Investment Partners, L.P. | 8,675 | 7,336 |
| Diamond Hill Research Partners International, L.P. | 1,434,111 | 1,384,976 |
| Diamond Hill Valuation-Weighted 500, L.P. | 2,548,723 | 2,258,249 |
| Total Investment Portfolio | \$ 21,148,293 | \$ 16,503,731 |

Table of ContentsNote 3 Investment Portfolio (Continued)

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

| | June 30, 2013 | As of December 31, 2012 |
|-------------------------------|--|--|
| Total partnership assets | \$ 116,493,564 | \$ 105,472,952 |
| Total partnership liabilities | 24,467,756 | 17,786,579 |
| Net partnership assets | \$ 92,025,808 | \$ 87,686,373 |
| DHCM's portion of net assets | \$ 3,991,509 | \$ 3,650,561 |
| | For the Six Months Ended June 30, 2013 | For the Year Ended December 31, 2012 |
| Net partnership income | \$ 15,182,661 | \$ 15,054,951 |
| DHCM's portion of net income | \$ 340,689 | \$ 472,659 |

Note 4 Capital StockCommon Shares

The Company has only one class of securities outstanding, Common Shares, no par value per share.

Authorization of Preferred Shares

The Company's Amended and Restated Articles of Incorporation authorize the issuance of 1,000,000 shares of blank check preferred shares with such designations, rights and preferences, as may be determined from time to time by the Company's Board of Directors. The Board of Directors is authorized, without shareholder approval, to issue preferred stock with dividend, liquidation, conversion, voting, or other rights, which could adversely affect the voting or other rights of the holders of the Common Shares. There were no preferred shares issued or outstanding at either June 30, 2013 or December 31, 2012.

Note 5 Compensation PlansEquity Incentive Plans*2011 Equity and Cash Incentive Plan*

At the Company's annual shareholder meeting on April 26, 2011, the shareholders approved the 2011 Equity and Cash Incentive Plan (2011 Plan). The 2011 Plan is intended to facilitate the Company's ability to attract and retain staff, provide additional incentive to employees, directors and consultants, and promote the success of the Company's business. The 2011 Plan authorizes the issuance of 600,000 Common Shares of the Company in various forms of equity awards. As of June 30, 2013, there were 228,570 Common Shares available for issuance under the 2011 Plan. The 2011 Plan provides that the Board of Directors, or a committee appointed by the Board, may grant awards and otherwise administer the 2011 Plan. Restricted stock grants issued under the 2011 Plan, which vest over time, are recorded as deferred compensation in the equity section of the balance sheet on the grant date and then recognized as compensation expense based on the grant date price over the vesting period of the respective grant.

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Note 5 Compensation Plans (Continued)

Equity Incentive Plans (Continued)

2005 Employee and Director Equity Incentive Plan

At the Company's annual shareholder meeting on May 12, 2005, the shareholders approved the 2005 Employee and Director Equity Incentive Plan ("2005 Plan"). There are no longer any Common Shares available for future issuance under the 2005 Plan, although outstanding grants under the 2005 Plan remain issued and outstanding. Restricted stock grants issued under the 2005 Plan, which vest over time, are recorded as deferred compensation in the equity section of the balance sheet on the grant date and then recognized as compensation expense based on the grant date price over the vesting period of the respective grant.

Restricted Stock Grant Transactions

The following table represents a roll-forward of outstanding restricted stock grants issued pursuant to the 2011 and 2005 Plans and related activity during the year ended December 31, 2012 and the six months ended June 30, 2013:

| | Shares | Weighted-Average Grant Date Price per Share |
|---|----------|---|
| Outstanding restricted stock grants as of December 31, 2011 | 260,621 | \$ 73.78 |
| Grants issued | 107,600 | 75.64 |
| Grants vested | (46,056) | 75.22 |
| Grants forfeited | (2,177) | 71.37 |
| | | |
| Outstanding restricted stock grants as of December 31, 2012 | 319,988 | \$ 74.22 |
| | | |
| Grants issued | 26,000 | 80.27 |
| Grants vested | (3,849) | (82.32) |
| Grants forfeited | | |
| | | |
| Total outstanding restricted stock grants as of June 30, 2013 | 342,139 | \$ 74.59 |

The total outstanding restricted stock grants shown above are included in issued and outstanding shares. Total deferred compensation related to unvested restricted stock grants was \$14,461,741 as of June 30, 2013. Expense recognition of deferred compensation over the remaining vesting periods is as follows:

Six Months

| Remaining In | 2014 | 2015 | 2016 | 2017 | 2018 | Total |
|--------------|--------------|--------------|--------------|--------------|------------|---------------|
| 2013 | \$ 4,762,207 | \$ 3,861,066 | \$ 2,026,538 | \$ 1,193,860 | \$ 157,861 | \$ 14,461,741 |

Table of ContentsNote 5 Compensation Plans (Continued)401(k) Plan

The Company sponsors a 401(k) plan under which all employees participate. Employees may contribute a portion of their compensation, subject to certain limits based on federal tax laws. The Company makes matching contributions of Common Shares of the Company with a value equal to 200 percent of the first six percent of an employee's compensation contributed to the plan. Employees become fully vested in the matching contributions after six plan years of employment. The following table summarizes the Company's expenses attributable to the plan during the three and six months ended June 30, 2013 and 2012:

| | June 30, 2013 | June 30, 2012 |
|--------------------|------------------|------------------|
| Three Months Ended | \$ 284,569 | \$ 264,802 |
| Six Months Ended | 564,782 | 517,721 |

Deferred Compensation Plans

On April 24, 2013, the Board of Directors approved the Diamond Hill Fixed Term Deferred Compensation Plan and the Diamond Hill Variable Term Deferred Compensation Plan (collectively the Plans). Under the Plans, participants may elect to voluntarily defer certain incentive compensation which the Company then contributes into the Plans. Each participant is responsible for designating investment options for assets they contribute and the distribution paid to each participant reflects any gains or losses on the assets realized while in the Plans. Assets held in the Plans will be included in the Company's investment portfolio and the associated obligation to participants is included in deferred compensation liability. Assets held in the Plans will consist of the Diamond Hill Funds and be recorded at fair value. The first contributions under the Plans are expected to be made in the first quarter of 2014.

Note 6 Operating Leases

The Company leases approximately 25,500 square feet of office space at two locations. The following table summarizes the total lease and operating expenses for the three and six months ended June 30, 2013 and 2012:

| | 2013 | 2012 |
|--------------------|------------|------------|
| Three Months Ended | \$ 164,351 | \$ 167,872 |
| Six Months Ended | 340,239 | 338,251 |

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

Six Months

| Remaining In 2013 | 2014 | 2015 | 2016 | Thereafter |
|----------------------|------------|------------|------------|------------|
| \$228,000 | \$ 454,000 | \$ 401,000 | \$ 234,000 | \$ |

In addition to the above rent, the Company will also be responsible for normal operating expenses of the properties. Such operating expenses were approximately \$9.69 per square foot in 2012, on a combined basis, and are expected to be approximately \$9.80 per square foot in 2013.

Table of ContentsNote 7 Income Taxes

The provision for income taxes for the three and six months ended June 30, 2013 and 2012 consists of federal, state and city income taxes. The effective tax rates for the three months ended June 30, 2013 and 2012 were 40.2% and 37.9%, respectively. The effective tax rates for the six months ended June 30, 2013 and 2012 were 38.5% and 37.3%, respectively. During 2012, the Company determined it was entitled to a tax deduction related to dividends paid on unvested restricted stock. The resulting tax benefit of \$1.9 million was recorded as a reduction of income taxes payable and an increase in shareholders' equity.

The net temporary differences incurred to date will reverse in future periods as the Company generates taxable earnings. The Company believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize the net deferred tax assets recorded. The Company records a valuation when it is more likely than not that some portion of all of the deferred tax assets will not be realized. As of June 30, 2013 and December 31, 2012, no valuation allowance was deemed necessary.

FASB ASC 740, *Income Taxes*, prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company did not record an accrual for tax related uncertainties or unrecognized tax positions as of June 30, 2013 and December 31, 2012. The Company does not expect a change to the reserve for uncertain tax positions within the next twelve months that would have a material impact on the consolidated financial statements. During the quarter ended June 30, 2013, the Company recorded through the tax provision net interest expense of \$294 thousand as a result of an IRS examination.

The Company files income tax returns in the federal and all applicable state and local jurisdictions. The Company is subject to federal, state and local examinations by tax authorities for tax years ended December 31, 2009 through 2012.

Note 8 Earnings Per Share

The following table sets forth the computation for EPS:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|--------------|---------------------------|--------------|
| | 2013 | 2012 | 2013 | 2012 |
| Net income | \$ 4,711,545 | \$ 3,328,097 | \$ 10,042,277 | \$ 7,939,450 |
| Weighted average number of outstanding shares | 3,248,197 | 3,101,170 | 3,222,977 | 3,066,002 |
| Earnings per share | \$ 1.45 | \$ 1.07 | \$ 3.12 | \$ 2.59 |

For the periods presented, the Company has unvested stock-based payment awards that contain nonforfeitable rights to dividends and are included in the computation of basic EPS above as participating shares. For the periods presented, the Company does not have dilutive securities outstanding.

Table of ContentsNote 9 Regulatory Requirements

BHIL, a wholly owned subsidiary of the Company and principal underwriter for mutual funds, is subject to the U.S. Securities and Exchange Commission (SEC) uniform net capital rule, which requires the maintenance of minimum net capital. BHIL s net capital exceeded its minimum net capital requirement at June 30, 2013 and December 31, 2012. The net capital balances, minimum net capital requirements, and ratios of aggregate indebtedness to net capital for BHIL are summarized below as of June 30, 2013 and December 31, 2012:

| | June 30, 2013 | December 31, 2012 |
|--|------------------|----------------------|
| Net Capital | \$ 397,875 | \$ 354,029 |
| Minimum Net Capital Requirement | 56,082 | 46,597 |
| Ratio of Aggregate Indebtedness to Net Capital | 2.11 to 1 | 1.97 to 1 |

Note 10 Commitments and Contingencies

The Company indemnifies its directors and certain of its officers and employees for certain liabilities that might arise from their performance of their duties to the Company. Additionally, in the normal course of business, the Company enters into agreements that contain a variety of representations and warranties and which provide general indemnifications. Certain agreements do not contain any limits on the Company s liability and would involve future claims that may be made against the Company that have not yet occurred. Therefore, it is not possible to estimate the Company s potential liability under these indemnities. Further, the Company maintains insurance policies that may provide coverage against certain claims under these indemnities.

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DIAMOND HILL INVESTMENT GROUP, INC.

ITEM 2: Management's Discussion and Analysis of Financial Condition and Results of Operations
Forward-looking Statements

Throughout this Quarterly report on Form 10-Q, the Company may make forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), relating to such matters as anticipated operating results, prospects for achieving the critical threshold of AUM, technological developments, economic trends (including interest rates and market volatility), expected transactions and acquisitions and similar matters. The words believe, expect, anticipate, estimate, should, hope, seek, plan, intend and similar expressions identify forward-looking statements that 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; changes in national and local economic and political conditions, including the effects of implementation of the American Taxpayer Relief Act of 2012 and the Jumpstart Our Business Startups Act of 2012 and the continuing economic uncertainty in various parts of the world; 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 U. S. Securities and Exchange Commission (SEC), including those in Item 1A on Form 10-K. When we use the terms the Company, management, we, us, and our, we mean Diamond Hill Investment Group, Inc. and its subsidiaries.

General

The Company, an Ohio corporation organized in 1990, derives its consolidated revenue and net income from investment advisory and fund administration services provided by its subsidiaries DHCM, BHFS, and BHIL. BHFS and BHIL collectively operate as Beacon Hill. DHCM is a registered investment adviser under the Investment Advisers Act of 1940. DHCM sponsors, distributes, and provides investment advisory and related services to various U.S. and foreign clients through the Funds, institutional accounts, and Partnerships. Beacon Hill provides fund administration and statutory underwriting services to various clients, including the Funds.

The Company's primary objective is to fulfill its fiduciary duty to clients. Its secondary objective is to grow the intrinsic value of the Company in order to achieve an adequate long-term return for shareholders.

In this section, the Company discusses and analyzes the consolidated results of operations for the three and six month periods ended June 30, 2013 and 2012 and other factors that may affect future financial performance. The accompanying unaudited consolidated financial statements were prepared in accordance with the instructions for Form 10-Q and, therefore, do not include information or footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with United States generally accepted accounting principles. Accordingly, these financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto of the Company included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. However, in the opinion of management, all adjustments (consisting of only normal recurring accruals) which are necessary for a fair presentation of the financial statements have been included. The results of operations for the three and six month periods ended June 30, 2013 are not necessarily indicative of the results which may be expected for the entire fiscal year.

Table of Contents**Assets Under Management**

The Company's revenue is derived primarily from investment advisory and administration fees. Investment advisory and administration fees paid to the Company are generally based on the value of the investment portfolios managed by the Company and fluctuate with changes in the total value of the AUM. Such fees are recognized in the period that the Company manages these assets. The Company's primary expense is employee compensation and benefits.

Revenues are highly dependent on both the value and composition of AUM. The following is a summary of the Company's AUM by product, investment objective, and a roll-forward of the change in AUM for the three and six months ended June 30, 2013 and 2012:

| (in millions) | Assets Under Management by Product | | |
|------------------------|---|-----------------|-----------------|
| | As of June 30, | | |
| | 2013 | 2012 | % Change |
| Proprietary funds | \$ 6,446 | \$ 4,761 | 35% |
| Sub-advised funds | 322 | 940 | -66% |
| Institutional accounts | 3,659 | 3,463 | 6% |
| Total AUM | \$ 10,427 | \$ 9,164 | 14% |

| (in millions) | Assets Under Management by Investment Objective | | |
|------------------|--|-----------------|-----------------|
| | As of June 30, | | |
| | 2013 | 2012 | % Change |
| Small Cap | \$ 1,113 | \$ 953 | 17% |
| Small-Mid Cap | 507 | 297 | 71% |
| Large Cap | 5,374 | 5,267 | 2% |
| Select (All Cap) | 278 | 273 | 2% |
| Long-Short | 2,955 | 2,174 | 36% |
| Strategic Income | 200 | 200 | 0% |
| Total AUM | \$ 10,427 | \$ 9,164 | 14% |

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| (in millions) | Change in Assets Under Management For the Three Months Ended June 30, | |
|---|--|-------------|
| | 2013 | 2012 |
| AUM at beginning of the period | \$ 10,574 | \$ 9,360 |
| Net cash inflows (outflows) proprietary funds | 218 | 137 |
| sub-advised funds | (782) | (15) |
| institutional accounts | (142) | 133 |
| | (706) | 255 |
| Net market appreciation (depreciation) and income | 559 | (451) |
| Decrease during the period | (147) | (196) |
| AUM at end of the period | \$ 10,427 | \$ 9,164 |

| (in millions) | Change in Assets Under Management For the Six Months Ended June 30, | |
|---|--|-------------|
| | 2013 | 2012 |
| AUM at beginning of the period | \$ 9,429 | \$ 8,671 |
| Net cash inflows (outflows) proprietary funds | 360 | 207 |
| sub-advised funds | (819) | (75) |
| institutional accounts | (175) | 20 |
| | (634) | 152 |
| Net market appreciation and income | 1,632 | 341 |
| Increase during the period | 998 | 493 |
| AUM at end of the period | \$ 10,427 | \$ 9,164 |

Table of Contents**Consolidated Results of Operations**

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

| (in thousands, except per share amounts) | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|---|-----------------------------|----------|----------|---------------------------|-----------|----------|
| | 2013 | 2012 | % Change | 2013 | 2012 | % Change |
| Net operating income | \$ 7,152 | \$ 5,831 | 23% | \$ 13,779 | \$ 11,851 | 16% |
| Net operating income after tax ^(a) | \$ 4,276 | \$ 3,619 | 18% | \$ 8,472 | \$ 7,435 | 14% |
| Net income | \$ 4,712 | \$ 3,328 | 42% | \$ 10,042 | \$ 7,939 | 26% |
| Net operating income after tax per share ^(a) | \$ 1.32 | \$ 1.17 | 13% | \$ 2.63 | \$ 2.42 | 9% |
| Net income per share | \$ 1.45 | \$ 1.07 | 36% | \$ 3.12 | \$ 2.59 | 20% |
| Operating profit margin | 36% | 36% | NM | 36% | 36% | NM |

(a) Net operating income after tax is a non-GAAP performance measure. See Use of Supplemental Data as Non-GAAP Performance Measure on page 25 of this report.

Three Months Ended June 30, 2013 compared with Three Months Ended June 30, 2012

The Company generated net income of \$4.7 million (\$1.45 per share) for the three months ended June 30, 2013, compared with net income of \$3.3 million (\$1.07 per share) for the three months ended June 30, 2012. Operating income increased by \$1.3 million period over period primarily due to an increase in AUM, resulting in a \$3.7 million increase in revenue. The revenue increase was offset by an increase in operating expenses of \$2.4 million, primarily related to an increase in compensation and related expenses. The Company's corporate investments also contributed to the overall increase in net income. Operating profit margin remained flat at 36% for the second quarter 2013 and 2012. The Company expects that its operating margin will fluctuate from period to period based on various factors including revenues; investment results; employee performance; staffing levels; development of investment strategies, products, or channels; and industry comparisons.

Revenue

| (in thousands) | Three Months Ended June 30, | | |
|---------------------------------|--------------------------------|------------------|------------|
| | 2013 | 2012 | % Change |
| Investment advisory | \$ 17,090 | \$ 14,101 | 21% |
| Mutual fund administration, net | 2,803 | 2,060 | 36% |
| Total | \$ 19,893 | \$ 16,161 | 23% |

As a percent of total second quarter 2013 revenues, investment advisory fees accounted for 86% and mutual fund administration fees made up the remaining 14%. This compared to 87% and 13%, respectively, for second quarter 2012.

Investment Advisory Fees. Investment advisory fees increased by \$3.0 million, or 21%, from the quarter ended June 30, 2012 to the quarter ended June 30, 2013. Investment advisory fees are calculated as a percentage of average net AUM at various rates depending on the investment product. The primary contributors to the increase in investment advisory fees were an increase of 16% in average AUM quarter over quarter and an increase of three basis points in the average advisory fee rate from 0.61% for the quarter ended June 30, 2012 to 0.64% for the quarter ended June 30, 2013. The increase in the average advisory fee rate is primarily due to a shift in the composition of AUM where long only strategies, which pay a lower advisory fee, made up 52% of total AUM as of June 30, 2013 compared to 57% of total AUM as of June 30, 2012, while long-short strategies, which have a higher advisory fee, made up 28% of total AUM as of June 30, 2013 compared to 24% of total AUM as of June 30, 2012.

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Mutual Fund Administration Fees. Mutual fund administration fees increased \$743 thousand, or 36%, from the quarter ended June 30, 2012 to the quarter ended June 30, 2013. Mutual fund administration fees include administration fees received from the Funds, which are calculated as a percentage of average mutual fund AUM, and all Beacon Hill fee revenue. The increase in the mutual fund administration fee is due to a 32% increase in average Funds AUM from \$4.7 billion for the quarter ended June 30, 2012 to \$6.2 billion for the quarter ended June 30, 2013 and an increase of two basis points in the net administration fee rate from 0.14% for the quarter ended June 30, 2012 to 0.16% for the quarter ended June 30, 2013.

Expenses

| (in thousands) | Three Months Ended June 30, | | % Change |
|--------------------------------|--------------------------------|-----------|----------|
| | 2013 | 2012 | |
| Compensation and related costs | \$ 10,358 | \$ 8,379 | 24% |
| General and administrative | 1,421 | 1,184 | 20% |
| Sales and marketing | 385 | 247 | 56% |
| Third party distribution | 158 | 138 | 14% |
| Mutual fund administration | 420 | 382 | 10% |
| Total | \$ 12,742 | \$ 10,330 | 23% |

Compensation and Related Costs. Employee compensation and benefits increased by \$2.0 million, or 24%, from the quarter ended June 30, 2012 to the quarter ended June 30, 2013, primarily due to an increase of \$1.5 million in incentive compensation and an increase of \$452 thousand in salaries and related benefits due to a 9% increase in staffing levels from 67 full-time equivalent employees as of June 30, 2012 to 73 full-time equivalent employees as of June 30, 2013.

General and Administrative. General and administrative expenses increased by \$237 thousand, or 20%, from the quarter ended June 30, 2012 to the quarter ended June 30, 2013. This increase is primarily due to additional research expenses to support the Company's investment team, corporate legal expenses, and expense related to a system implementation.

Sales and Marketing. Sales and marketing expenses increased by \$138 thousand, or 56%. This increase was primarily due to an overall increase in travel and other expenses related to business development and retention efforts during second quarter 2013 and one time consulting expenses related to a review of DHCM's marketing materials.

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

Mutual Fund Administration. Mutual fund administration expenses increased by \$38 thousand, or 10%, from the quarter ended June 30, 2012 to the quarter ended June 30, 2013. The majority of mutual fund administration fees are variable based upon the amount of mutual fund AUM or the number of shareholder accounts. The increase is primarily due to an increase in the average Funds AUM of 32% from the quarter ended June 30, 2012 to the quarter ended June 30, 2013 offset by a decrease in shareholder maintenance costs during 2013.

Table of Contents**Six Months Ended June 30, 2013 compared with Six Months Ended June 30, 2012**

The Company generated net income of \$10.0 million (\$3.12 per share) for the six months ended June 30, 2013, compared with net income of \$7.9 million (\$2.59 per share) for the six months ended June 30, 2012. Operating income increased by \$1.9 million period over period primarily due to an increase in AUM, resulting in a \$5.5 million increase in revenue. The revenue increase was offset by an increase in operating expenses of \$3.6 million, primarily related to an increase in compensation and related expenses. The Company's corporate investments also contributed to the overall increase in net income. Operating profit margin remained flat at 36% period over period. The Company expects that its operating margin will fluctuate from period to period based on various factors including revenues; investment results; employee performance; staffing levels; development of investment strategies, products, or channels; and industry comparisons.

Revenue

| (in thousands) | Six Months Ended June 30, | | % Change |
|---------------------------------|------------------------------|------------------|------------|
| | 2013 | 2012 | |
| Investment advisory | \$ 32,944 | \$ 28,476 | 16% |
| Mutual fund administration, net | 5,305 | 4,299 | 23% |
| Total | \$ 38,249 | \$ 32,775 | 17% |

As a percent of 2013 year to date revenues, investment advisory fees accounted for 86% and mutual fund administration fees accounted for the remaining 14% compared to the 2012 period where investment advisory fees accounted for 87% and mutual fund administration fees accounted for the remaining 13% of revenues.

Investment Advisory Fees. Investment advisory fees increased by \$4.5 million, or 16%, from the six months ended June 30, 2012 to the six months ended June 30, 2013. Investment advisory fees are calculated as a percentage of average net AUM at various rates depending on the investment product. The primary contributor to the increase in investment advisory fees is an increase of 14% in average AUM from the six months ended June 30, 2012 compared to the six months ended June 30, 2013, while the average advisory fee rate remained consistent period over period at 0.63%.

Mutual Fund Administration Fees. Mutual fund administration fees increased \$1.0 million, or 23%, from the six months ended June 30, 2012 to the six months ended June 30, 2013. Mutual fund administration fees include administration fees received from the Funds, which are calculated as a percentage of average mutual fund AUM, and all Beacon Hill fee revenue. The increase in the mutual fund administration fee is due to a 29% increase in average Funds AUM from \$4.5 billion for the six months ended June 30, 2012 to \$5.8 billion for the six months ended June 30, 2013 and an increase of one basis point in the net administration fee rate from 0.15% for the six months ended June 30, 2012 to 0.16% for the six months ended June 30, 2013.

Expenses

| (in thousands) | Six Months Ended June 30, | | % Change |
|--------------------------------|------------------------------|------------------|------------|
| | 2013 | 2012 | |
| Compensation and related costs | \$ 19,871 | \$ 16,866 | 18% |
| General and administrative | 2,814 | 2,402 | 17% |
| Sales and marketing | 652 | 476 | 37% |
| Third party distribution | 305 | 352 | -13% |
| Mutual fund administration | 828 | 828 | 0% |
| Total | \$ 24,470 | \$ 20,924 | 17% |

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Compensation and Related Costs. Employee compensation and benefits increased by \$3.0 million, or 18%, from the six months ended June 30, 2012 compared to the six months ended June 30, 2013, primarily due to an increase of \$2.0 million in incentive compensation and an increase of \$987 thousand in salaries and related benefits due to a 9% increase in staffing levels from 67 full-time equivalent employees as of June 30, 2012 to 73 full-time equivalent employees as of June 30, 2013.

General and Administrative. General and administrative expenses increased by \$411 thousand, or 17%, from the six months ended June 30, 2012 compared to the six months ended June 30, 2013. This increase is primarily due to additional research expenses to support the Company's investment team, corporate legal expenses, and expense related to a system implementation.

Sales and Marketing. Sales and marketing expenses increased by \$176 thousand, or 37%, from the six months ended June 30, 2012 compared to the six months ended June 30, 2013. This increase was primarily due to an overall increase in travel and other expenses related to business development and retention efforts during 2013 and one time consulting expenses related to a review of DHCM's marketing materials.

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

Mutual Fund Administration. Mutual fund administration expenses remained flat period over period. The majority of mutual fund administration fees are variable based upon the amount of mutual fund AUM or the number of shareholder accounts. While mutual fund administration expense remained flat period over period, the average Funds AUM increased by 29% from \$4.5 billion as of June 30, 2012 to \$5.8 billion as of June 30, 2013 offset by a decrease in shareholder maintenance costs during 2013.

Liquidity and Capital Resources

Sources of Liquidity

The Company's main source of liquidity is cash flow from operating activities which is generated from investment advisory and fund administration fees. The Company's entire investment portfolio is in readily marketable securities, which provide for cash liquidity, if needed. Investments in mutual funds are valued at their quoted current net asset value. Investments in private investment funds are valued independently based on readily available market quotations. Inflation is expected to have no material impact on the Company's performance. Cash and cash equivalents, accounts receivables, and investments represent approximately 86% and 84% of total assets as of June 30, 2013 and December 31, 2012 respectively. The Company believes these sources of liquidity as well as continuing cash flows from operating activities will be sufficient to meet current and future operating needs for at least the next 12 months.

Uses of Liquidity

In line with the Company's primary objective to fulfill its fiduciary duty to clients and secondary objective to achieve an adequate long-term return for shareholders, the Company anticipates the main uses of cash will be operating expenses.

The Board of Directors and management continually review various factors to determine whether the Company has capital in excess of that required for the business and the appropriate use of any excess capital. The factors considered include the Company's investment opportunities, the Company's risks, and future dividend and capital gain tax rates. Evaluating management's stewardship of capital for shareholders is a central part of the Company's investment discipline that it practices for its clients. The Company holds itself to the same standard when evaluating investments for its clients.

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Working Capital

As of June 30, 2013, the Company had working capital of approximately \$33.7 million compared to \$17.6 million at December 31, 2012. Working capital includes cash, securities owned and current receivables, net of all liabilities. On December 5, 2012, the Company's Board of Directors declared an \$8.00 per share dividend payable on December 21, 2012 to shareholders of record on December 17, 2012. The payment of the special cash dividend reduced the Company's working capital balance. The Company has no debt, and believes its available working capital is sufficient to cover current expenses. The Company does not expect any material capital expenditures during 2013.

Cash Flow Analysis

Cash Flows from Operating Activities

The Company's cash flows from operating activities are calculated by adjusting net income to reflect other significant operating sources and uses of cash, certain significant non-cash items such as share-based compensation, and timing differences in the cash settlement of operating assets and liabilities.

For the six month periods ended June 30, 2013 and 2012, net cash provided by operating activities totaled \$7.4 million and \$6.3 million, respectively. The changes in net cash provided by operating activities generally reflect net income plus the effect of non-cash items and the timing differences in the cash settlement of assets and liabilities.

Cash Flows from Investing Activities

The Company's cash flows from investing activities consist primarily of capital expenditures and the purchase and redemption of the Company's investment portfolio.

For the six months ended June 30, 2013, net cash used in investing activities totaled \$2.3 million primarily due to purchases into the Company's corporate investments and purchases of furniture and equipment. For the six months ended June 30, 2012, net cash used in investing activities totaled \$6.4 million primarily due to purchases into the Company's corporate investments.

Cash Flows from Financing Activities

The Company's cash flows from financing activities consist primarily of the payment of special dividends, the repurchase of Common Shares, and the payment of taxes withheld on employee stock transactions offset by the proceeds from the issuance of Common Shares.

For the six months ended June 30, 2013, net cash used in financing activities totaled \$57 thousand related to the payment of taxes withheld on employee stock transactions. For the six months ended June 30, 2012, net cash used in financing activities totaled \$335 thousand primarily related to the payment of taxes withheld on employee stock transactions offset by excess income tax benefit from stock-based compensation.

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

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

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

| (in thousands, except per share data) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|----------|---------------------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| Net operating income, GAAP basis | \$ 7,152 | \$ 5,831 | \$ 13,779 | \$ 11,851 |
| Non-GAAP adjustments: | | | | |
| Tax provision excluding impact of investment income | 2,876 | 2,212 | 5,307 | 4,416 |
| Net operating income after tax, non-GAAP basis | \$ 4,276 | \$ 3,619 | \$ 8,472 | \$ 7,435 |
| Net operating income after tax per share, non-GAAP basis | \$ 1.32 | \$ 1.17 | \$ 2.63 | \$ 2.42 |
| Weighted average shares outstanding, GAAP basis | 3,248 | 3,101 | 3,223 | 3,066 |

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

Off-Balance Sheet Arrangements

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

Critical Accounting Policies and Estimates

There have been no material changes to the Critical Accounting Policies and Estimates provided in Item 7 of the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

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DIAMOND HILL INVESTMENT GROUP, INC.

ITEM 3: Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in the information provided in Item 7A of the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

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) 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 Exchange Act, 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 Exchange Act is accumulated and communicated to the Company’s management, including the Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

There have been no changes in the Company’s internal control over financial reporting during the six-month period ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II: OTHER INFORMATION

ITEM 1: Legal Proceedings

From time to time, the Company is party to ordinary routine litigation that is incidental to its business. There are currently no material legal proceedings pending to which the Company or any subsidiary is a party.

ITEM 1A: Risk Factors

There has been no material change to the information provided in Item 1A of the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

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

The Company did not purchase any of its Common Shares during the quarter ended June 30, 2013. The following table sets forth information regarding the Company’s repurchase program of its Common Shares during the second quarter of fiscal year 2013:

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as part of Publicly Announced Plans or Programs | Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (1) |
|--------|----------------------------------|------------------------------|--|--|
| | | | | |

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| | |
|--------------------------------------|---------|
| April 1, 2013 through April 30, 2013 | 318,433 |
| May 1, 2013 through May 31, 2013 | 318,433 |
| June 1, 2013 through June 30, 2013 | 318,433 |

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- (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 the Company's Common Shares 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: Mine Safety Disclosures

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.)
- 10.1 Diamond Hill Fixed Term Deferred Compensation Plan (Incorporated by reference from the Current Report on Form 8-K for the event on April 24, 2013, filed with the SEC on April 30, 2013, Exhibit 10.1; File No. 000-24498.)
- 10.2 Diamond Hill Variable Term Deferred Compensation Plan (Incorporated by reference from the Current Report on Form 8-K for the event on April 24, 2013 filed with the SEC on April 30, 2013, Exhibit 10.2; File No. 000-24498.)
- 10.3 First Amendment to the Diamond Hill Fixed Term Deferred Compensation Plan (Incorporated by reference from the Current Report on Form 8-K for the event on May 21, 2013 filed with the SEC on May 28, 2013, Exhibit 10.1; File No. 000-24498.)
- 10.4 First Amendment to the Diamond Hill Variable Term Deferred Compensation Plan (Incorporated by reference from the Current Report on Form 8-K for the event on May 21, 2013 filed with the SEC on May 28, 2013, Exhibit 10.2; File No. 000-24498.)
- 31.1 Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a).
- 31.2 Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a).
- 32.1 Section 1350 Certifications.
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

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DIAMOND HILL INVESTMENT GROUP, INC.

SIGNATURES

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

DIAMOND HILL INVESTMENT GROUP, INC.

| Date | Title | Signature |
|----------------|--|--------------------------------------|
| August 2, 2013 | President, Chief Executive Officer, and a Director | /s/ R. H. Dillon R. H. Dillon |
| August 2, 2013 | Chief Financial Officer, Treasurer, Secretary, and a Director | /s/ James F. Laird James F. Laird |