DIAMOND HILL INVESTMENT GROUP INC
Form 10-Q
July 27, 2016
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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, 2016
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 of principal executive offices) (Zip Code)
(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: x 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 x 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.

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Large accelerated filer ¨ Accelerated filer x

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: x

The number of shares outstanding of the issuer’s common stock, as of July 27, 2016, is 3,426,208 shares.

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DIAMOND HILL INVESTMENT GROUP, INC.

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PART I: FINANCIAL INFORMATION

ITEM 1: Consolidated Financial Statements
Diamond Hill Investment Group, Inc.
Consolidated Balance Sheets

	6/30/2016 (Unaudited)	12/31/2015
ASSETS		
Cash and cash equivalents	$70,744,395	$57,474,777
Investment portfolio	57,981,889	52,490,820
Accounts receivable	16,845,662	18,579,302
Prepaid expenses	1,661,141	1,780,105
Property and equipment, net of depreciation	4,188,057	4,253,361
Income taxes receivable	3,497,546	1,402,137
Deferred taxes	9,455,137	9,206,079
Total assets	$164,373,827	$145,186,581
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Accounts payable and accrued expenses	$6,502,832	$7,651,324
Accrued incentive compensation	10,958,500	21,984,500
Deferred compensation	12,552,132	10,236,743
Total liabilities	30,013,464	39,872,567
Redeemable noncontrolling interest	5,745,386	—
Shareholders' equity		
Common stock, no par value 7,000,000 shares authorized; 3,425,389 issued and outstanding at June 30, 2016 (inclusive of 228,923 unvested shares); 3,414,338 issued and outstanding at December 31, 2015 (inclusive of 310,356 unvested shares)	110,115,374	102,536,527
Preferred stock, undesignated, 1,000,000 shares authorized and unissued	—	—
Deferred equity compensation	(22,552,883)	(19,294,784)
Retained earnings	41,052,486	22,072,271
Total shareholders' equity	128,614,977	105,314,014
Total liabilities and shareholders' equity	$164,373,827	$145,186,581
Book value per share	$37.55	$30.84

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
REVENUES:				
Investment advisory	$28,553,082	$27,018,876	$55,239,867	$52,419,412
Mutual fund administration, net	4,116,353	4,363,311	7,887,057	8,281,182
Total revenue	32,669,435	31,382,187	63,126,924	60,700,594
OPERATING EXPENSES:				
Compensation and related costs	13,381,347	12,667,426	25,780,056	25,452,206
General and administrative	2,575,941	2,583,567	5,061,100	4,577,113
Sales and marketing	1,061,046	1,160,451	2,054,168	1,770,152
Mutual fund administration	951,852	848,657	1,827,918	1,585,030
Total operating expenses	17,970,186	17,260,101	34,723,242	33,384,501
NET OPERATING INCOME	14,699,249	14,122,086	28,403,682	27,316,093
Investment income	692,666	457,340	1,439,888	1,802,023
INCOME BEFORE TAXES	15,391,915	14,579,426	29,843,570	29,118,116
Income tax expense	(5,624,808)	(5,401,304)	(10,796,584)	(10,427,372)
NET INCOME	9,767,107	9,178,122	19,046,986	18,690,744
Less: Net income attributable to redeemable noncontrolling interest	(52,555)	—	(66,771)	—
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$9,714,552	$9,178,122	$18,980,215	$18,690,744
Earnings per share attributable to common shareholders				
Basic	$2.85	$2.79	$5.58	$5.75
Diluted	$2.84	$2.73	$5.58	$5.61
Weighted average shares outstanding				
Basic	3,410,751	3,287,751	3,399,740	3,253,144
Diluted	3,415,192	3,367,280	3,403,198	3,331,521

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

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Diamond Hill Investment Group, Inc.
Consolidated Statements of Shareholders' Equity and Redeemable Noncontrolling Interest (unaudited)

	Shares Outstanding	Common Stock	Deferred Equity Compensation	Retained Earnings	Total	Redeemable Noncontrolling Interest
Balance at January 1, 2015	3,317,728	$84,855,693	$(12,566,133)	$2,029,664	$74,319,224	$ —
Issuance of restricted stock grants	73,000	10,341,320	(10,341,320)	—	—	—
Amortization of restricted stock grants	—	—	3,309,999	—	3,309,999	—
Issuance of stock grants	27,192	3,826,458	—	—	3,826,458	—
Issuance of common stock related to 401k plan match	4,815	764,437	—	—	764,437	—
Net excess tax benefit from vested restricted stock grants	—	1,619,727	—	—	1,619,727	—
Shares withheld related to employee tax withholding	(23,063)	(3,235,603)	—	—	(3,235,603)	—
Forfeiture of restricted stock grants	(3,500)	(272,335)	272,335	—	—	—
Net income	—	—	—	18,690,744	18,690,744	—
Balance at June 30, 2015	3,396,172	$97,899,697	$(19,325,119)	$20,720,408	$99,294,986	$ —
Balance at January 1, 2016	3,414,338	$102,536,527	$(19,294,784)	$22,072,271	$105,314,014	$ —
Cumulative-effect adjustment from the adoption of ASU 2015-02 (Note 2)	—	—	—	—	—	4,031,756
Issuance of restricted stock grants	33,600	6,699,184	(6,699,184)	—	—	—
Amortization of restricted stock grants	—	—	3,235,146	—	3,235,146	—
Issuance of stock grants	21,940	3,879,431	—	—	3,879,431	—
Issuance of common stock related to 401k plan match	5,276	935,210	—	—	935,210	—
Tax benefit from dividend payments related to restricted stock grants	—	925,000	—	—	925,000	—
Net excess tax benefit from vested restricted stock grants	—	4,421,408	—	—	4,421,408	—
Shares withheld related to employee tax withholding	(48,165)	(9,075,447)	—	—	(9,075,447)	—
Forfeiture of restricted stock grants	(1,600)	(205,939)	205,939	—	—	—
Net income	—	—	—	18,980,215	18,980,215	66,771
Net issuance of ETF shares to noncontrolling shareholders	—	—	—	—	—	1,646,859
Balance at June 30, 2016	3,425,389	$110,115,374	$(22,552,883)	$41,052,486	$128,614,977	$ 5,745,386

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

	Six Months Ended June 30, 2016		2015	
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net Income	$ 19,046,986		$ 18,690,744	
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation	334,327		279,024	
Stock-based compensation	4,170,356		4,074,437	
(Increase)/decrease in accounts receivable	1,733,640		(1,505,693	)
Change in current income taxes	3,250,999		(1,566,748	)
Change in deferred income taxes	(249,058	)	(795,408	)
Net investment income	(1,226,058	)	(1,786,994	)
Decrease in accrued incentive compensation	(7,146,569	)	(3,411,792	)
Increase in deferred compensation	2,315,389		4,532,517	
Excess income tax benefit from stock-based compensation	(4,421,408	)	(1,619,727	)
Income tax benefit from dividends paid on restricted stock	(925,000	)	—	
Other changes in assets and liabilities	693,251		227,075	
Net cash provided by operating activities	17,576,855		17,117,435	
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchase of property and equipment	(248,835	)	(722,352	)
Cost of seed capital investments purchased	(6,133,800	)	(11,040,594	)
Proceeds from sale of seed capital investments	6,510,550		3,492,995	
Net cash provided by (used in) investing	127,915		(8,269,951	)

activities		
CASH FLOWS FROM FINANCING ACTIVITIES:		
Value of shares withheld related to employee tax withholding	(9,075,447)	(3,235,604)
Excess income tax benefit from stock-based compensation	4,421,408	1,619,727
Income tax benefit from dividends paid on restricted stock	925,000	—
Net redemptions of redeemable noncontrolling interest	(706,113)	—
Net cash used in financing activities	(4,435,152)	(1,615,877)
CASH AND CASH EQUIVALENTS		
Net change during the period	13,269,618	7,231,607
At beginning of period	57,474,777	35,777,140
At end of period	$ 70,744,395	$ 43,008,747
Supplemental cash flow information:		
Income taxes paid	$ 7,794,643	$ 12,789,528
Supplemental disclosure of non-cash transactions:		
Common stock issued as incentive compensation	$ 3,879,431	$ 3,826,458
Charitable donation of corporate investments	1,729,735	1,401,202
Cumulative-effect adjustment from the adoption of ASU 2015-02 (Note 2)	4,031,756	—
Net issuance of ETF shares for marketable securities	2,254,210	—

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 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"), an exchange traded fund (the "ETF"), and other institutional accounts. In addition, DHCM is administrator for the Funds.
Beacon Hill Fund Services, Inc. ("BHFS"), an Ohio corporation, is a wholly owned subsidiary of the Company. BHFS provides compliance, treasury, and other fund administration services to investment advisers and mutual funds. BHIL Distributors, Inc. ("BHIL"), an Ohio corporation, is a wholly owned subsidiary of BHFS. BHIL provides underwriting services to mutual funds. BHFS and BHIL collectively operate as "Beacon Hill". On June 15, 2016, the Company entered into a definitive agreement with Foreside Financial Group, LLC (“Foreside”), to sell BHIL and certain assets and liabilities of BHFS to Foreside. This transaction will result in the entirety of Beacon Hill’s business being transferred to Foreside. The completion of the transaction is subject to customary closing conditions and although there can be no assurance, we expect the transaction to close on July 31, 2016. See Note 10.
Note 2 Significant Accounting Policies
Basis of Presentation
The accompanying unaudited condensed consolidated financial statements as of June 30, 2016 and December 31, 2015, and for the three and six month periods ended June 30, 2016 and 2015, for Diamond Hill Investment Group, Inc. and its subsidiaries (referred to in these notes to the condensed consolidated financial statements as "the Company," "management," "we," "us," and "our") have been prepared in accordance with United States generally accepted accounting principles ("GAAP") and with the instructions to Form 10-Q and Article 10 of the Securities and Exchange Commission ("SEC") Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair statement of the financial condition and results of operations at the dates and for the interim periods presented, have been included. The results of operations for any interim period are not necessarily indicative of the results of operations to be expected for any full fiscal year. These unaudited condensed consolidated financial statements and footnotes should be read in conjunction with the audited consolidated financial statements of the Company included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015 ("2015 Annual Report") as filed with the SEC.
Use of Estimates
The preparation of the condensed consolidated financial statements in conformity with GAAP requires management of the Company to make estimates and assumptions related to the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.
Reclassification
Certain prior period amounts and disclosures may have been reclassified to conform to the current period's financial presentation.
Principles of Consolidation
The accompanying consolidated financial statements include the operations of the Company and its controlled subsidiaries. All inter-company transactions and balances have been eliminated in consolidation.
The Company holds certain investments in the Funds and the ETF we advise for general corporate investment purposes and to provide seed capital for newly formed strategies. The Funds are organized in a series fund structure in which there are multiple mutual funds within one Trust. The Trust is an open-end investment company registered under the Investment Company Act of

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1940, as amended (the"1940 Act"). The ETF we advise is an individual series of ETF Series Solutions which is also an open-end investment company registered under the 1940 Act. Each of the individual mutual funds and the ETF represent a separate share class of a legal entity organized under the trust. As of January 1, 2016, the Company adopted ASU 2015-02 - Consolidation (Topic 810): Amendments to the Consolidation Analysis ("ASU 2015-02") and we have performed our analysis at the individual mutual fund and ETF level and have concluded the mutual funds and ETF are voting rights entities ("VREs"). The Company has concluded that the mutual funds and the ETF are VREs because the structure of the investment product is such that the shareholders are deemed to have the power through voting rights to direct the activities that most significantly impact the entity's economic performance. To the extent material, these investment products are consolidated if Company ownership, directly or indirectly, represents a majority interest (greater than 50%). The Company records redeemable noncontrolling interests in consolidated investments for which the Company's ownership is less than 100%.

In 2016, the Company consolidated the ETF as our ownership was greater than 50%. We adopted ASU 2015-02 utilizing the modified retrospective transition method and have recorded a cumulative-effect adjustment to equity of $4.0 million as of January 1, 2016. Prior to the adoption of ASU 2015-02, we performed our analysis at the trust level and concluded we did not need to consolidate the Funds or the ETF as we owned less than 1% of the voting interest in the respective trusts.

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”) and Diamond Hill Global Fund, L.P. ("DHGF"), each a limited partnership whose underlying assets consist primarily of marketable securities, or collectively (the "Partnerships" or “LPs”).

DHCM is wholly owned by the Company and is consolidated by us. Further, DHCM, through its control of the General Partner, has the power to direct each LP’s economic activities and the right to receive investment advisory fees that may be significant to the LPs.

The Company concluded we did not have a variable interest in DHIP as the fees paid to the General Partner are considered to contain customary terms and conditions as found in the market for similar products and the Company has no equity ownership in DHIP.

The Company concluded DHGF was a variable interest entity ("VIE") as DHCM has disproportionately less voting interests than economic interests because the Company receives over 95% of the variability of DHGF, yet the Limited Partners have full power to remove the Company as the General Partner due to the existence of substantive kick-out rights. In addition, substantially all of the LPs' activities are conducted on behalf of the General Partner which has disproportionately few voting rights. The Company concluded we are not the primary beneficiary of DHGF as we lack the power to control the entity due to the existence of single-party kick-out rights where the limited partner has the unilateral ability to remove us as the General Partner without cause. DHCM’s investment in DHGF is reported as a component of the Company’s investment portfolio, valued at DHCM’s proportionate interest in the net asset value ("NAV") of DHGF.

The LPs are not subject to lock-up periods and can be redeemed on demand. Gains and losses attributable to changes in the value of DHCM’s interests in the LPs are included in the Company’s reported investment income. The Company’s exposure to loss as a result of its involvement with the LPs is limited to the amount of its investments. DHCM is not obligated to provide, and has not provided, financial or other support to the LPs, other than its investments to date and its contractually provided investment advisory responsibilities. The Company has not provided liquidity arrangements, guarantees or other commitments to support the LPs’ operations, and the LPs’ 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 and are not subject to a management fee or an incentive fee. These individuals receive no remuneration as a result of their personal investment in DHIP. The capital of the General Partner is not subject to a management fee or an incentive fee.

Redeemable Noncontrolling Interest

Redeemable noncontrolling interest represents third-party interests in the Company's consolidated ETF. This interest is redeemable at the option of the investors and therefore is not treated as permanent equity. Redeemable noncontrolling interest is remeasured at redemption value which approximates the fair value each reporting period.

Segment Information

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

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Cash and Cash Equivalents

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

Accounts Receivable

Accounts receivable are recorded when they are due and are presented on 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 June 30, 2016 or December 31, 2015. Accounts receivable from the Funds were $9.2 million as of both June 30, 2016 and December 31, 2015.

Investments

Management determines the appropriate classification of its investments at the time of purchase and re-evaluates its determination at each reporting period.

Investments classified as trading represent seed capital investments in the Funds we advise where the Company has neither control nor the ability to exercise significant influence as well as equity securities held in the consolidated ETF. These investments are measured at fair value based on quoted market prices. Unrealized gains and losses are recorded as investment income in the Company's consolidated statements of income.

Investments classified as equity method investments represent seed capital investments in which the Company owns between 20-50% of the outstanding voting interests in the entity or when it is determined that the Company is able to exercise significant influence but not control over the investments. When using the equity method, the Company recognizes its respective share of the investee's net income or loss for the period which is recorded as investment income in the Company's consolidated statements of income.

Valuation of Investment Portfolio

Level 1 inputs are defined as fair values that use quoted prices in active markets for identical assets or liabilities. The following table summarizes the values of the Company’s investments based upon Level 1 inputs as of June 30, 2016:

	June 30, 2016
Level 1 Inputs	$102,624,785

Level 1 investments are all registered investment companies (mutual funds) and include, as of June 30, 2016, $46.0 million of investments in third party money market mutual funds that the Company classifies as cash equivalents. In accordance with Subtopic 820-10, certain investments in limited partnerships that are measured at fair value using NAV as a practical expedient have not been classified in the fair value hierarchy. There were $1.4 million of investments in limited partnerships that were measured at NAV at June 30, 2016. The Company determines transfers between fair value hierarchy levels at the end of the reporting period. There were no transfers in or out of the levels during the six months ended June 30, 2016.

Changes in fair values of the investments are recorded in the Consolidated Statements of Income as investment income.

Property and Equipment

Property and equipment, consisting of leasehold improvements, computer equipment, furniture, and fixtures, are carried at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated lives of the assets.

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Revenue Recognition – General

The Company earns substantially all of its revenue from investment advisory and fund administration services. Investment advisory and administration fees, generally calculated as a percentage of assets under management ("AUM"), are recorded as revenue as services are performed. In addition to fixed fees based on a percentage of AUM, certain client accounts also provide periodic variable incentive fees. Investment advisory revenue from the Funds was \$22.0 million and \$20.0 million for the three months ended June 30, 2016 and June 30, 2015, respectively. Investment advisory revenue from the Funds was \$42.3 million and \$38.5 million for the six months ended June 30, 2016 and June 30, 2015, respectively.

Revenue Recognition – Variable Incentive Fees

The Company manages certain client accounts that provide for variable incentive fees. These fees are calculated based on client investment results over rolling five-year periods. The Company records variable incentive fees at the end of the contract measurement period. No variable incentive fees were earned during the three and six months ended June 30, 2016 or 2015. The table below shows AUM subject to variable incentive fees and the amount of variable incentive fees that would be recognized if the contracts were terminated as of June 30, 2016:

	As of June 30, 2016
AUM subject to variable incentive fees	$548,212,294

	As of June 30, 2016
Contractual Period Ends:	
Quarter Ended June 30, 2017	$—
Quarter Ended December 31, 2018	—
Quarter Ended September 30, 2019	180,471
Quarter Ended March 31, 2020	—
Total variable incentive fees that would be recognized if contract terminated	$180,471

The contractual end dates highlight the time remaining until the variable incentive fees are scheduled to be earned. The amount of variable incentive fees that would be recognized if the contracts were terminated as of June 30, 2016 will increase or decrease based on future client investment results through the contractual period end. There can be no assurance that the above amounts will ultimately be earned.

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, fund accounting, transfer agency and other related functions. For performing these services each Fund pays DHCM a fee, which is calculated using an annual rate times the average daily net assets of each respective share class. For the first half of 2016 and the entire fiscal year 2015, the annual rate was 0.24% for Class A and C shares and 0.10% for Class Y shares. For the first half of 2016, the annual rate was 0.20% for Class I shares. In 2015, the rate for Class I shares was 0.21% beginning July 1, 2015 and 0.24% prior to July 1, 2015.

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 advances the upfront commissions that are paid to brokers who sell Class C shares of the Funds. These advances are capitalized and amortized over 12 months to correspond with the repayments DHCM receives from the principal underwriter to recoup this commission advancement.

Beacon Hill has underwriting and administrative service agreements with certain clients, including registered mutual funds. The fee arrangements vary from client to client based upon services provided and are recorded as revenue under mutual fund administration on the Consolidated Statements of Income. Part of Beacon Hill's role as underwriter is to act as an agent on behalf of its mutual fund clients to receive 12b-1/service fees and commission revenue and facilitate the payment of those fees and commissions to third parties who provide services to the funds and their shareholders. The majority of 12b-1/service fees are paid to independent third parties and the remainder are retained by the Company as reimbursement for expenses the Company has incurred. 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,	
	2016	2015	2016	2015
Mutual fund administration:				
Administration revenue, gross	$7,350,583	$6,883,451	$14,111,452	$13,263,411
12b-1/service fees and commission revenue received from fund clients	2,801,257	2,799,190	5,426,648	5,543,341
12b-1/service fees and commission expense payments to third parties	(2,500,742)	(2,418,508)	(4,829,232)	(4,792,371)
Fund related expense	(3,553,932)	(2,908,128)	(6,821,995)	(5,746,922)
Revenue, net of related expenses	4,097,166	4,356,005	7,886,873	8,267,459
DHCM C-Share financing:				
Broker commission advance repayments	207,599	247,922	400,909	499,281
Broker commission amortization	(188,412)	(240,616)	(400,725)	(485,558)
Financing activity, net	19,187	7,306	184	13,723
Mutual fund administration revenue, net	$4,116,353	$4,363,311	$7,887,057	$8,281,182

Mutual fund administrative net revenue from the Funds was $3.0 million and $3.5 million for the three months ended June 30, 2016 and June 30, 2015, respectively. Mutual fund administrative net revenue from the Funds was $5.8 million and $6.6 million for the six months ended June 30, 2016 and June 30, 2015, respectively.

Income Taxes

The Company accounts for current and deferred income taxes through an asset and liability approach. 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 and applicable 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 it 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

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June 30, 2016, the Company had not recorded any liability for uncertain tax positions. The Company records interest and penalties, if any, within income tax expense on the income statement.

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, which includes participating securities. Diluted EPS reflects the potential dilution of EPS due to unvested restricted stock grants with forfeitable rights to dividends and restricted stock units. For the periods presented, the Company has unvested stock-based payment awards that contain both forfeitable and nonforfeitable rights to dividends and restricted stock units. See Note 8.

Recently Issued Accounting Standards

In May 2014, the FASB issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers", which supersedes existing accounting standards for revenue recognition and creates a single framework. ASU 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. This standard also specifies the accounting for certain costs to obtain or fulfill a contract with a customer. This ASU will supersede much of the existing revenue recognition guidance in GAAP and is effective for fiscal years beginning after December 15, 2017, including interim periods within that reporting period, and requires either a retrospective or a modified retrospective approach to adoption. The Company is currently assessing the impact of this standard on its consolidated financial statements and related disclosures, as well as the transition methods. Early application is permitted for the first interim period within annual reporting periods beginning after December 15, 2016.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting", which is intended to improve the accounting for share-based payment transactions as part of the FASB's simplification initiative. The ASU changes seven aspects of the accounting for share-based payment award transactions, including: (1) accounting for income taxes; (2) classification of excess tax benefits on the statement of cash flows; (3) forfeitures; (4) minimum statutory tax withholding requirements; (5) classification of employee taxes paid on the statement of cash flows when an employer withholds share for tax-withholding purposes; (6) practical expedient - expected term (nonpublic only); and (7) intrinsic value (nonpublic only). The ASU is effective for fiscal years beginning after December 15, 2016, and interim periods within those years. Early adoption is permitted in any interim or annual period provided that the entire ASU is adopted. The Company is currently assessing the impact of this standard on its consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, "Leases", which, among other things, requires lessees to recognize most leases on-balance sheet. This will increase their reported assets and liabilities - in some cases significantly. Lessor accounting remains substantially similar to current GAAP. ASU 2016-02 supersedes Topic 840, Leases. ASU 2016 is effective for annual and interim periods in fiscal years beginning after December 15, 2018. ASU 2016-02 mandates a modified retrospective transition method for all entities. The Company is currently assessing the impact of this standard on its consolidated financial statements and related disclosures.

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Note 3 Investment Portfolio

As of June 30, 2016, the Company held investments (excluding third party money market funds which are included with cash and cash equivalents) worth $58.0 million. The following table summarizes the fair value of these investments as of June 30, 2016:

	As of June 30, 2016
Trading investments:	
Equity securities held in consolidated ETF[(a)]	$17,793,918
Seed capital investments	883,419
Equity method investments	26,752,420
Deferred compensation investments	12,552,132
Total Investment portfolio	$57,981,889

(a) Of the equity interests in consolidated ETF as of June 30, 2016, $12.1 million were held directly by the Company and $5.7 million were held by noncontrolling shareholders.

The deferred compensation investments above consist of Diamond Hill Funds and relate to deferred compensation liabilities from both deferred compensation plans (refer to Note 5). As of June 30, 2016, trading investments and equity method investments held in deferred compensation investments were $8.3 million and $4.3 million, respectively.

The assets of the Company's equity method investments are cash, marketable equity securities and fixed income securities. The following table includes summary financial information from the Company's equity method investments as of and for the period ended June 30, 2016:

	As of June 30, 2016
Total assets	$127,728,288
Total liabilities	16,434,374
Net assets	111,293,914
DHCM's portion of net assets	31,008,157

	For the Six Months Ended June 30, 2016
Net income	1,683,908
DHCM's portion of net income	1,030,069

Note 4 Line of Credit

The Company has an uncommitted Line of Credit Agreement (the "Credit Agreement") with a commercial bank that matures in November of 2016 and permits the Company to borrow up to $10.0 million. Borrowings under the Credit Agreement bear interest at a rate equal to LIBOR plus 1.50%. The Company has not borrowed under the Credit Agreement as of and for the periods ended June 30, 2016 and December 31, 2015. No interest is payable on the unused portion of the Credit Agreement.

The proceeds of the Credit Agreement may be used by the Company and its subsidiaries for ongoing working capital needs and other general corporate purposes. The Credit Agreement contains representations, warranties and covenants that are customary for agreements of this type.

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Note 5 Compensation Plans

Share-Based Payment Transactions

The Company issues restricted stock units and restricted stock awards (collectively, "Restricted Stock") under the 2014 Equity and Cash Incentive Plan ("2014 Plan"). Restricted stock units represent shares that may be issued in the future, whereas restricted stock awards represent shares issued and outstanding upon grant with vesting restrictions. The following table represents a roll-forward of outstanding Restricted Stock and related activity during the six months ended June 30, 2016:

	Shares	Weighted-Average Grant Date Price per Share
Outstanding Restricted Stock as of December 31, 2015	329,356	$ 108.46
Grants issued	36,600	183.04
Grants vested	(113,433)	82.94
Grants forfeited	(1,600)	128.71
Total Outstanding Restricted Stock as of June 30, 2016	250,923	$ 130.74

As of June 30, 2016, there were 400,469 Common Shares available for awards under the 2014 Plan.

Total deferred compensation related to unvested Restricted Stock grants was $22.6 million as of June 30, 2016. Compensation expense related to the Restricted Stock grants is calculated based upon the fair market value of the Common Shares on grant date, adjusted for estimated forfeitures. The recognition of compensation expense related to deferred compensation over the remaining vesting periods, adjusted for estimated forfeitures, is as follows:

Six Months Remaining In 2016	2017	2018	2019	2020	Thereafter	Total
$3,662,157	$6,628,713	$4,772,771	$3,876,251	$2,159,040	$1,453,951	$22,552,883

Stock Grant Transactions

The following table represents stock issued as part of our incentive compensation program during the six months ended June 30, 2016 and 2015:

	Shares Issued	Grant Date Value
June 30, 2016	21,940	$3,879,431
June 30, 2015	27,192	3,826,458

Deferred Compensation Plans

The Company offers two deferred compensation plans, the Diamond Hill Fixed Term Deferred Compensation Plan and the Diamond Hill Variable Term Deferred Compensation Plan (collectively the “Plans”), to its employees. Under the Plans, participants may elect to voluntarily defer, for a minimum of five years, certain incentive compensation, that 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 are included in the Company’s investment portfolio and the associated obligation to participants is included in deferred compensation liability. Assets held in the Plans are recorded at fair value. Deferred compensation liability was $12.6 million and $10.2 million as of June 30, 2016 and December 31, 2015, respectively.

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Note 6 Operating Leases
The Company currently leases office space of approximately 42,400 square feet at two locations. The following table summarizes the total lease and operating expenses for the three and six months ended June 30, 2016 and 2015:

	June 30, 2016	June 30, 2015
Three Months Ended	$233,207	$234,333
Six Months Ended	$460,555	$462,797

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

Future Minimum Lease Payments						
Six Months Remaining In 2016	2017	2018	2019	2020	Thereafter	Total
$348,099	$696,198	$632,120	$595,807	$624,179	$2,341,000	$5,237,403

In addition to the above lease payments, the Company is also responsible for normal operating expenses of the properties. Such operating expenses were approximately $0.4 million in 2015, on a combined basis, and are expected to be the same to be in 2016.
Note 7 Income Taxes
The Company has determined its interim tax provision projecting an estimated annual effective tax rate. For the three months ended June 30, 2016, the Company recorded income tax expense of $5.6 million, yielding an effective tax rate of 36.5%. The effective tax rate of 36.5% differed from the federal statutory rate of 35% due primarily to the additional income tax expense recorded in the state and city jurisdictions in which we do business. For the six months ended June 30, 2016, the Company recorded income tax expense of $10.8 million, yielding an effective tax rate of 36.2%. The effective tax rate of 36.2% differed from the federal statutory tax rate of 35% due primarily to the additional income tax expense recorded in the state and city jurisdictions in which we do business, which was partially offset by a $0.1 million tax benefit related to a charitable donation of appreciated securities previously held in our investment portfolio.
For the three months ended June 30, 2015, the Company recorded income tax expense of $5.4 million, yielding an effective tax rate of 37.0%. The effective tax rate of 37.0% differed from the expected effective tax rate of 35% due to additional income tax expense recorded in the state and city jurisdictions in which we do business. For the six months ended June 30, 2015, the Company recorded income tax expense of $10.4 million, yielding an effective tax rate of 35.8%. The effective tax rate of 35.8% differed from the federal statutory tax rate of 35% due primarily to the additional income tax expense recorded in the state and city jurisdictions in which we do business, which was partially offset by a $0.2 million tax benefit related to a charitable donation of appreciated securities previously held in our investment portfolio.
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 allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. As of June 30, 2016 and December 31, 2015, no valuation allowance was deemed necessary.
The Company's income taxes payable have been reduced by excess tax benefits from equity incentive plan awards. These tax benefits are considered windfall tax benefits under ASC 718 and are recognized as an increase to common stock. For Restricted Stock, the Company receives an excess income tax benefit calculated as the tax effect of the difference between the fair market value of the stock at the time of grant and vesting. The Company also records a tax benefit on dividends paid on Restricted Stock. The Company had net tax benefits from equity awards of $5.3 million

and $1.6 million for the six months ended June 30, 2016 and 2015, respectively, which were reflected as increases in equity.
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

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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, 2016 or December 31, 2015.

Note 8 Earnings Per Share

The Company’s Common Shares outstanding consist of all shares issued and outstanding, including unvested restricted shares. Basic and diluted EPS are calculated under the two-class method. Pursuant to the two-class method, the Company’s unvested Restricted Stock grants with nonforfeitable rights to dividends are considered participating securities. Dividends are paid on all Common Shares outstanding at the same rate. Accordingly, the Company has evaluated the impact of earnings per share of all participating securities under the two-class method, noting no impact on earnings per share. Restricted stock awards with forfeitable rights to dividends and restricted stock units are considered dilutive. The following table sets forth the computation for basic and diluted EPS and reconciliation between basic and diluted shares outstanding:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net Income	$9,767,107	$9,178,122	$19,046,986	$18,690,744
Less: Net income attributable to redeemable noncontrolling interest	(52,555)	—	(66,771)	—
Net income attributable to common shareholders	$9,714,552	$9,178,122	$18,980,215	$18,690,744
Weighted average number of outstanding shares - Basic	3,410,751	3,287,751	3,399,740	3,253,144
Dilutive impact of restricted stock awards with forfeitable rights to dividends	—	73,485	—	73,715
Dilutive impact of restricted stock units	4,441	6,044	3,458	4,662
Weighted average number of outstanding shares - Diluted	3,415,192	3,367,280	3,403,198	3,331,521
Earnings per share attributable to common shareholders				
Basic	$2.85	$2.79	$5.58	$5.75
Diluted	$2.84	$2.73	$5.58	$5.61

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Note 9 Commitments and Contingencies

The Company indemnifies its directors, officers and certain of its employees for certain liabilities that might arise from their performance of their duties to the Company. From time to time, the Company is involved in legal matters relating to claims arising in the ordinary course of business. There are currently no such matters pending that the Company believes could have a material adverse effect on its consolidated financial statements.

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.

Note 10 Subsequent Event

On June, 15, 2016, the Company entered into a definitive agreement with Foreside, to sell BHIL and certain assets and liabilities of BHFS to Foreside. This transaction will result in the entirety of Beacon Hill’s business being transferred to Foreside. The completion of the transaction is subject to customary closing conditions and although there can be no assurance, we expect the transaction to close on July 31, 2016. The Company expects the one-time impact to increase consolidated net income by approximately $1.3 million in the third quarter of 2016.

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

Forward-looking Statements

Throughout this Quarterly Report on Form 10-Q, the Company may make forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, relating to such matters as anticipated operating results, prospects and levels of assets under management, technological developments, economic trends (including interest rates and market volatility), expected transactions and similar matters. The words "believe," "expect," "anticipate," "estimate," "should," "hope," "seek," "plan," "in similar expressions identify forward-looking statements that speak only as of the date thereof. While we believe that the assumptions underlying our forward-looking statements are reasonable, investors are cautioned that any of the assumptions could prove to be inaccurate and, accordingly, our actual results and experiences could differ materially from the anticipated results or other expectations expressed in our 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 our products; changes in interest rates; changes in national and local economic and political conditions; the continuing economic uncertainty in various parts of the world; changes in government policy and regulation, including monetary policy; changes in our 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 other public documents on file with the SEC.

General

The Company derives its consolidated revenue and net income from investment advisory and fund administration services provided by its subsidiaries, DHCM and 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, the ETF, and the Partnerships. Beacon Hill provides fund administration and statutory underwriting services to U.S. and foreign clients, including the Funds. The Company's primary objective is to fulfill our fiduciary duty to our clients. Our secondary objective is to grow the intrinsic value of the Company in order to achieve an adequate long-term return for shareholders.

Assets Under Management

Our 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 we manage and fluctuate with changes in the total value of our AUM. Substantially all of our AUM (97.4%) is valued based on readily available market quotations. AUM in the fixed income strategies (2.6%) is valued using evaluated prices from an independent third-party provider. Fees are recognized in the period that the Company manages these assets. Revenues are highly dependent on both the value and composition of AUM. The following is a summary of our AUM by product and investment objective, and a roll-forward of the change in AUM for the three and six months ended June 30, 2016 and 2015:

	Assets Under Management by Product		
	As of June 30,		
(in millions except percentages)	2016	2015	% Change
Proprietary funds	$ 12,238	$ 10,858	13 %
Sub-advised funds	614	734	(16)%
Institutional accounts	4,732	5,142	(8)%
Total AUM	$ 17,584	$ 16,734	5 %

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(in millions except percentages)	Assets Under Management by Investment Objective As of June 30, 2016	2015	% Change
Small Cap	$1,787	$1,640	9 %
Small-Mid Cap	2,794	1,830	53 %
Large Cap	7,728	7,961	(3)%
Select (All Cap)	471	565	(17)%
Long-Short	4,349	4,456	(2)%
Fixed Income	455	282	61 %
Total AUM	$17,584	$16,734	5 %

(in millions)	Change in Assets Under Management For the Three Months Ended June 30, 2016	2015
AUM at beginning of the period	$17,391	$16,098
Net cash inflows (outflows)		
proprietary funds	194	353
sub-advised funds	(15)	(16)
institutional accounts	(106)	99
	73	436
Net market appreciation and income	120	200
Increase during the period	193	636
AUM at end of the period	$17,584	$16,734

(in millions)	Change in Assets Under Management For the Six Months Ended June 30, 2016	2015
AUM at beginning of the period	$16,841	$15,656
Net cash inflows (outflows)		
proprietary funds	551	827
sub-advised funds	(55)	25
institutional accounts	(66)	(130)
	430	722
Net market appreciation and income	313	356
Increase during the period	743	1,078
AUM at end of the period	$17,584	$16,734

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Consolidated Results of Operations
The following is a discussion of our consolidated results of operations.

	Three Months Ended June 30,			Six Months Ended June 30,		
(in thousands, except per share amounts and percentages)	2016	2015	% Change	2016	2015	% Change
Net operating income	$14,699	$14,122	4 %	$28,404	$27,316	4 %
Net operating income after tax[(a)]	$9,327	$8,890	5 %	$18,128	$17,534	3 %
Net income attributable to common shareholders	$9,715	$9,178	6 %	$18,980	$18,691	2 %
Net operating income after tax per diluted share[(a)]	$2.73	$2.64	3 %	$5.33	$5.26	1 %
Earnings per share attributable to common shareholders (Diluted)	$2.84	$2.73	4 %	$5.58	$5.61	(1)%
Operating profit margin	45 %	45 %		45 %	45 %	

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

Three Months Ended June 30, 2016 compared with Three Months Ended June 30, 2015
The Company generated net income attributable to common shareholders of $9.7 million ($2.84 per diluted share) for the three months ended June 30, 2016, compared with net income attributable to common shareholders of $9.2 million ($2.73 per diluted share) for the three months ended June 30, 2015. Revenue increased $1.3 million period over period due to an increase in average AUM. The revenue increase was partially offset by an increase in operating expenses of $0.7 million primarily related to increases in compensation and related expenses. The Company had $0.7 million in investment income due to market appreciation for the three months ended June 30, 2016 compared to investment income of $0.5 million for the three months ended June 30, 2015. Income tax expense increased $0.2 million from the three months ended June 30, 2015 to the three months ended June 30, 2016 due to the overall increase in income before taxes.
Net operating income after tax, which excludes the impact of investment gains or losses, increased $0.4 million, or 5%, from the three months ended June 30, 2015 to the three months ended June 30, 2016 consistent with the increase in net operating income.
Operating profit margin was 45% for the quarters ended both June 30, 2016 and June 30, 2015. We expect that our operating margin may 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

	Three Months Ended June 30,		
(in thousands except percentages)	2016	2015	% Change
Investment advisory	$28,553	$27,019	6 %
Mutual fund administration, net	4,116	4,363	(6)%
Total	$32,669	$31,382	4 %

As a percent of total revenues for the second quarter of 2016 and 2015, investment advisory fees accounted for 87% and 86%, respectively, and mutual fund administration fees made up the remaining 13% and 14%, respectively.
Investment Advisory Fees. Investment advisory fees increased $1.5 million, or 6%, from the three months ended June 30, 2015 to the three months ended June 30, 2016. Investment advisory fees are calculated as a percentage of the market value of client accounts at contractual fee rates that vary by investment product. The increase in investment advisory fees was driven by an increase of 7% in average AUM quarter over quarter offset by a decrease of two basis

points in the average advisory fee rate from 0.66% for the three months ended June 30, 2015 to 0.64% for the three months ended June 30, 2016. The decrease in the average advisory fee rate is due to a 0.05% reduction in the Large Cap Fund advisory fee effective January 1, 2016 and the

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closing of certain strategies to new investors. Effective April 30, 2016, the Diamond Hill Small-Mid Cap strategy was closed to new investors. The Small Cap strategy was closed to new investors as of December 31, 2015 and the Long-Short strategy was closed to new investors as of June 12, 2015. As a result, the Company expects the recent growth in AUM in these Funds to decline, which could negatively impact the average advisory fee rate.

Mutual Fund Administration Fees. Mutual fund administration fees decreased $0.2 million, or 6%, from the three months ended June 30, 2015 to the three months ended June 30, 2016. Mutual fund administration fees include administration fees received from the Funds, which are calculated as a percentage of average Funds' AUM, and all Beacon Hill fee revenue. The decrease in mutual fund administration fees is due to a decrease of three basis points in the net administration fee rate from 0.13% for the three months ended June 30, 2015 to 0.10% for the three months ended June 30, 2016, offset by a 15% increase in average Funds' AUM from $10.6 billion for the three months ended June 30, 2015 to $12.2 billion for the three months ended June 30, 2016. This decrease in the net administration fee rate was due to a four basis point fee reduction to the Funds' administration fee rate on assets held in Class I shares from 0.24% for the quarter ended June 30, 2015 to 0.20% for the quarter ended June 30, 2016.

Effective August 1, 2016, the Company expects to further reduce the administration fee rate charged on assets held in Class I shares by one basis point from 0.20% to 0.19% and reduce the administration fee rate charged on assets held in Class Y shares by one basis point from 0.10% to 0.09%. As of June 30, 2016, assets held in Class I shares and Class Y shares for the Diamond Hill Funds totaled $7.5 billion and $1.8 billion, respectively.

Expenses

	Three Months Ended June 30,		
(in thousands except percentages)	2016	2015	% Change
Compensation and related costs	$13,381	$12,667	6 %
General and administrative	2,576	2,584	— %
Sales and marketing	1,061	1,160	(9)%
Mutual fund administration	952	849	12 %
Total	$17,970	$17,260	4 %

Compensation and Related Costs. Employee compensation and benefits increased by $0.7 million, or 6%, from the three months ended June 30, 2015 compared to the three months ended June 30, 2016, due to an increase of $0.9 million in salaries and related benefits due to merit increases and increases in staffing levels which was offset by a reduction in deferred compensation expense of $0.1 million and a decrease in restricted stock expense of $0.1 million. Incentive compensation expense can fluctuate significantly period over period as we evaluate incentive compensation by reviewing investment results in client portfolios, individual performance, Company performance, and other factors.

General and Administrative. General and administrative expenses remained consistent from the three months ended June 30, 2015 to the three months ended June 30, 2016.

Sales and Marketing. Sales and marketing expenses decreased by $0.1 million or 9%, from the three months ended June 30, 2015 to the three months ended June 30, 2016.

Mutual Fund Administration. Mutual fund administration expenses increased by $0.1 million, or 12%, from the three months ended June 30, 2015 to the three months ended June 30, 2016. Mutual fund administration expenses consist of both variable and fixed expenses. The variable expenses are based on Fund AUM, which increased 15%, and the number of shareholder accounts.

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Six Months Ended June 30, 2016 compared with Six Months Ended June 30, 2015

The Company generated net income attributable to common shareholders of $19.0 million ($5.58 per diluted share) for the six months ended June 30, 2016, compared with net income attributable to common shareholders of $18.7 million ($5.61 per diluted share) for the six months ended June 30, 2015. Revenue increased $2.4 million period over period due to an increase in AUM. The revenue increase was partially offset by an increase in operating expenses of $1.3 million. The Company had $1.4 million in investment income due to market appreciation for the six months ended June 30, 2016 compared to an investment income of $1.8 million for the six months ended June 30, 2015.

Net operating income after tax, which excludes the impact of investment gains or losses, increased $0.6 million, or 3%, from the six months ended June 30, 2015 to the six months ended June 30, 2016 consistent with the increase in net operating income.

Operating profit margin was 45% for both the six months ended June 30, 2016 and the six months ended June 30, 2015. We expect that our operating margin may 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 except percentages)	Six Months Ended June 30, 2016	2015	% Change
Investment advisory	$55,240	$52,420	5 %
Mutual fund administration, net	7,887	8,281	(5)%
Total	$63,127	$60,701	4 %

As a percent of total revenues for the six months ended June 30, 2016 and 2015, investment advisory fees accounted for 88% and 86%, respectively, and mutual fund administration fees made up the remaining 12% and 14%, respectively.

Investment Advisory Fees. Investment advisory fees increased $2.8 million, or 5%, from the six months ended June 30, 2015 to the six months ended June 30, 2016. Investment advisory fees are calculated as a percentage of the market value of client accounts at contractual fee rates which vary by investment product. The increase in investment advisory fees was driven by an increase of 6% in average AUM period over period offset by a decrease of one basis point in the average advisory fee rate from 0.65% for the six months ended June 30, 2015 to 0.64% for the six months ended June 30, 2016. Effective April 30, 2016, the Diamond Hill Small-Mid Cap strategy was closed to new investors. The Small Cap strategy was closed to new investors as of December 31, 2015 and the Long-Short strategy was closed to new investors as of June 12, 2015. As a result of these strategies closing to new investors, the Company expects the recent growth in AUM in these Funds to decline, which could negatively impact the average advisory fee rate.

Mutual Fund Administration Fees. Mutual fund administration fees decreased $0.4 million, or 5%, from the six months ended June 30, 2015 to the six months ended June 30, 2016. Mutual fund administration fees include administration fees received from the Funds, which are calculated as a percentage of average Funds' AUM, and all Beacon Hill fee revenue. The decrease in mutual fund administration fees is due to a decrease of three basis points in the net administration fee rate from 0.13% for the six months ended June 30, 2015 to 0.10% for the six months ended June 30, 2016, partially offset by a 14% increase in average Funds' AUM from $10.3 billion for the six months ended June 30, 2015 to $11.7 billion for the six months ended June 30, 2016. This decrease in the net administration fee rate was due to a four basis point fee reduction to the Funds' administration fee rate on assets held in Class I shares from 0.24% for the six months ended June 30, 2015 to 0.20% for six months ended June 30, 2016.

Effective August 1, 2016, the Company expects to further reduce the administration fee rate charged on assets held in Class I shares by one basis point from 0.20% to 0.19% and reduce the administration fee rate charged on assets held in Class Y shares by one basis point from 0.10% to 0.09%. As of June 30, 2016, assets held in Class I shares and Class Y shares for the Diamond Hill Funds totaled $7.5 billion and $1.8 billion, respectively.

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Expenses

(in thousands except percentages)	Six Months Ended June 30, 2016	2015	% Change	
Compensation and related costs	$25,780	$25,452	1	%
General and administrative	5,061	4,577	11	%
Sales and marketing	2,054	1,770	16	%
Mutual fund administration	1,828	1,585	15	%
Total	$34,723	$33,384	4	%

Compensation and Related Costs. Employee compensation and benefits increased by $0.3 million, or 1%, from the six months ended June 30, 2015 to the six months ended June 30, 2016, due to an increase of $2.3 million in salaries and related benefits due to merit increases and increases in staffing levels offset by a decrease of $1.9 million in incentive compensation expense. Incentive compensation expense can fluctuate significantly period over period as we evaluate incentive compensation by reviewing investment results in client portfolios, individual performance, company performance, and other factors.

General and Administrative. General and administrative expenses increased by $0.5 million, or 11%, from the six months ended June 30, 2015 to the six months ended June 30, 2016. This increase is due to an increase in depreciation of $0.1 million, additional research expenses to support our investment team of $0.2 million, and an increase in information technology expense of $0.2 million.

Sales and Marketing. Sales and marketing expenses increased by $0.3 million, or 16%, from the six months ended June 30, 2015 to the six months ended June 30, 2016. The increase was primarily due to additional payments made to third party intermediaries related to the sale of our proprietary funds.

Mutual Fund Administration. Mutual fund administration expenses increased by $0.2 million, or 15%, from the six months ended June 30, 2015 to the six months ended June 30, 2016. Mutual fund administration expenses consist of both variable and fixed expenses. The variable expenses are based on Fund AUM and the number of shareholder accounts. The expense was consistent with the 14% increase in average Funds' AUM from the six months ended June 30, 2015 to the six months ended June 30, 2016.

Liquidity and Capital Resources

Sources of Liquidity

Our current financial condition is highly liquid, with a significant amount of our assets comprised of cash and cash equivalents, seed capital investments, and accounts receivable (together, liquid assets). Our main source of liquidity is cash flow from operating activities, which is generated from investment advisory and fund administration fees. Cash and cash equivalents, accounts receivable, and investments represented approximately 89% of total assets as of June 30, 2016 and December 31, 2015, respectively. We believe these sources of liquidity, as well as our continuing cash flows from operating activities, will be sufficient to meet our 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 our fiduciary duty to clients and secondary objective to achieve an adequate long-term return for shareholders, we anticipate our main uses of cash will be for operating expenses and seed capital to fund new and existing investment strategies.

The Board of Directors and management regularly review various factors to determine whether we have capital in excess of that required for the business and the appropriate use of any excess capital. The factors considered include our investment opportunities, capital needed for investment strategies, risks, and future dividend and capital gain tax rates. Evaluating management’s stewardship of capital for shareholders is a central part of our investment discipline that we practice for our clients. We hold ourselves to the same standard.

In July of 2016, the Company started two new funds, the Diamond Hill Core Bond Fund and the Diamond Hill Short Duration Total Return Fund. In the third quarter of 2016, the Company plans to seed the Diamond Hill Core Bond Fund with approximately $20 million and Diamond Hill Short Duration Total Return Fund with approximately $10 million.

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Working Capital

As of June 30, 2016, the Company had working capital of approximately $115.0 million, compared to $91.9 million at December 31, 2015. Working capital includes cash, securities owned by common shareholders, prepaid expenses and current receivables, net of all liabilities. The Company has no debt and we believe our available working capital is sufficient to cover current expenses and anticipated capital expenditures.

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 months ended June 30, 2016, net cash provided by operating activities totaled $17.6 million. For the six months ended June 30, 2015, net cash provided by operating activities totaled $17.1 million. The changes in net cash provided by operating activities generally reflects net income plus the effect of non-cash items and the timing differences in the cash settlement of assets and liabilities. We expect that cash flows provided by operating activities will continue to serve as our primary source of working capital in the near future.

Cash Flows from Investing Activities

The Company’s cash flows from investing activities consist primarily of capital expenditures and purchases and redemptions in our investment portfolio.

Cash flows provided by investing activities totaled $0.1 million for the six months ended June 30, 2016. The Company sold seed capital investments of $6.5 million offset by purchases of seed capital investments of $6.1 million (inclusive of $4.4 million of purchases into our deferred compensation plans) during the period. The Company also purchased $0.2 million of property and equipment during the period.

Cash flows used in investing activities totaled $8.3 million for the six months ended June 30, 2015. During the period, the Company converted the Diamond Hill Valuation-Weighted 500, L.P. to the Diamond Hill Valuation-Weighted 500 ETF by liquidating its investment of $3.5 million in the partnership and purchasing $6.6 million into the Diamond Hill Valuation-Weighted 500 ETF. Additionally, the Company purchased $4.3 million into our deferred compensation plans. The Company also purchased $0.7 million of property and equipment related to our office space expansion.

Cash Flows from Financing Activities

The Company’s cash flows from financing activities may consist of the payment of special dividends, shares withheld related to employee tax withholding, excess income tax benefit from stock-based compensation, the income tax benefit from dividends paid on restricted stock, and distributions to or contributions from redeemable noncontrolling interest.

For the six months ended June 30, 2016, net cash used in financing activities totaled $4.4 million, consisting of the value of shares withheld related to employee tax withholding of $9.1 million and net redemptions of redeemable noncontrolling interest of $0.7 million, partially offset by excess income tax benefit from stock-based compensation of $4.4 million and income tax benefit from dividends paid on restricted stock of $0.9 million.

For the six months ended June 30, 2015, net cash used in financing activities totaled $1.6 million, consisting of the value of shares withheld related to employee tax withholding of $3.2 million, partially offset by excess income tax benefit from stock-based compensation of $1.6 million.

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 GAAP ("non-GAAP") for "Net Operating Income After Tax" that management uses as a benchmark in evaluating and comparing the period-to-period operating performance of the Company and its subsidiaries.

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The Company defines "net operating income after tax" as the Company's net operating income less its income tax provision, excluding investment related activity and the tax impact of the investment related activity. 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 related activity 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.

	Three Months Ended June 30,			Six Months Ended June 30,		
(in thousands, except per share data and percentages)	2016	2015	% Change	2016	2015	% Change
Net operating income, GAAP basis	$14,699	$14,122	4 %	$28,404	$27,316	4 %
Non-GAAP adjustments:						
Tax provision excluding impact of investment income	(5,372)	(5,232)	3 %	(10,276)	(9,782)	5 %
Net operating income after tax, non-GAAP basis	$9,327	$8,890	5 %	$18,128	$17,534	3 %
Net operating income after tax per diluted share, non-GAAP basis	$2.73	$2.64	3 %	$5.33	$5.26	1 %
Diluted weighted average shares outstanding, GAAP basis	3,415	3,367		3,403	3,332	

The tax provision excluding impact of investment related activity 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. We do 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

For a summary of the critical accounting policies important to understanding the condensed consolidated financial statements see Note 2, Significant Accounting Policies, in the condensed consolidated financial statements contained in Part I, Item 1 of this filing and Critical Accounting Policies in Management's Discussion and Analysis of Financial Condition and Results of Operations in the 2015 Form 10-K and Note 2, Significant Accounting Policies, in the 2015 Form 10-K for further information.

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 2015 Annual Report.

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 Exchange Act) as of the end of the period covered by this quarterly report (the "Evaluation Date"). Based on that 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 SEC'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.

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There have been no changes in the Company’s internal control over financial reporting during the quarter ended June 30, 2016 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

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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 such matters pending that the Company believes could have a material adverse effect on its consolidated financial statements.

ITEM 1A: Risk Factors
There has been no material change to the information provided in Item 1A of the Company’s 2015 Annual Report.

ITEM 2: Unregistered Sales of Equity Securities and Use of Proceeds
During the quarter ended June 30, 2016, the Company did not purchase any of its Common Shares and did not sell any Common Shares that were not registered under the Securities Act of 1933. The following table sets forth information regarding the Company’s repurchase program of its Common Shares and shares withheld for tax payments due upon vesting of employee Restricted Stock which vested during the second quarter of fiscal year 2016:

Period	Total Number of Shares Purchased[a]	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[b]
April 1, 2016 through April 30, 2016	1,733	$ 173.94	—	318,433
May 1, 2016 through May 31, 2016	—	$ —	—	318,433
June 1, 2016 through June 30, 2016	—	$ —	—	318,433
Total	1,733	$ 173.94	—	318,433

(a) All of the 1,733 shares of the Company's common shares purchased during the quarter ended June 30, 2016 represented shares withheld for tax payments due upon the vesting of employee Restricted Stock which vested during the quarter.

(b) 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 share 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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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	Amended and Restated Code of Regulations of the Company (Incorporated by reference from Form 8-K Current Report, Exhibit 3.1, filed with the SEC on August 7, 2014; 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 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
July 27, 2016	Chief Executive Officer and President	/s/ Christopher M. Bingaman Christopher M. Bingaman
July 27, 2016	Chief Financial Officer and Treasurer	/s/ Thomas E. Line Thomas E. Line

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