Pzena Investment Management, Inc.
Form 10-Q
December 05, 2007

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

þ	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the quarterly period ended September 30, 2007**
	OR
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the transition period from: _____ to _____**

Commission File Number 001-33761

PZENA INVESTMENT MANAGEMENT, INC.
(Exact name of registrant as specified in its charter)

Delaware *(State or other jurisdiction of incorporation or organization)*	**20-8999751** *(I.R.S. Employer Identification No.)*
120 West 45th Street, New York, New York *(Address of principal executive offices)*	**10036** *(Zip Code)*

(212) 355-1600
(Registrant s telephone number including area code)

Not Applicable
(Former name, former address, and former fiscal year; if changed since last report)

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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes o No þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

At December 5, 2007, 6,111,118 shares of the Class A Common Stock ($.01 par value per share) of the Registrant were outstanding. At December 5, 2007, 57,937,910 shares of the Class B Common Stock ($0.000001 par value per share) of the Registrant were outstanding.

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EXPLANATORY NOTE

On October 30, 2007, Pzena Investment Management, Inc. consummated an initial public offering of 6,100,000 shares of its Class A common stock in which it received net proceeds of approximately $99.1 million that it used to purchase 6,100,000 membership units of Pzena Investment Management, LLC, representing 9.5% of the then outstanding membership units of Pzena Investment Management, LLC. Concurrently with the consummation of this initial public offering, (i) the operating agreement of Pzena Investment Management, LLC was amended and restated such that, among other things, Pzena Investment Management, Inc. became the sole managing member of Pzena Investment Management, LLC and (ii) related reorganization transactions were consummated. Accordingly, as of and subsequent to October 30, 2007, (i) Pzena Investment Management, Inc. will consolidate the financial results of Pzena Investment Management, LLC with its own and reflect the remaining 90.5% membership interest in Pzena Investment Management, LLC as a non-controlling interest in its consolidated financial statements, and (ii) Pzena Investment Management, Inc. s income will be generated by its 9.5% economic interest in Pzena Investment Management, LLC s net income. Therefore, this Quarterly Report on Form 10-Q presents the following financial statements:

(1) the consolidated financial statements of Pzena Investment Management, LLC as of December 31, 2006 and September 30, 2007 and for the three and nine months ended September 30, 2006 and 2007; and

(2) the financial statements of Pzena Investment Management, Inc. as of May 10, 2007 (capitalization) and September 30, 2007 and for the period May 10, 2007 (capitalization) through September 30, 2007.

We, us, our, and the company refer to: (i) Pzena Investment Management, Inc. and its subsidiaries, including Pzena Investment Management, LLC and all of its subsidiaries, following the consummation of the above-referenced initial public offering, amendment and restatement of the operating agreement of Pzena Investment Management, LLC and related reorganization transactions on October 30, 2007, and (ii) to Pzena Investment Management, LLC and all of its subsidiaries prior to the consummation of these transactions. Our operating company refers to Pzena Investment Management, LLC.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements. Forward-looking statements provide our current expectations, or forecasts, of future events. Forward-looking statements include statements about our expectations, beliefs, plans, objectives, intentions, assumptions and other statements that are not historical facts. Words or phrases such as anticipate, believe, continue, ongoing, estimate, expect, intend, may, plan, project or similar words or phrases, or the negatives of those words or phrases, may identify forward-looking statements, but the absence of these words does not necessarily mean that a statement is not forward-looking.

Forward-looking statements are subject to known and unknown risks and uncertainties and are based on potentially inaccurate assumptions that could cause actual results to differ materially from those expected or implied by the forward-looking statements. Our actual results could differ materially from those anticipated in forward-looking statements for many reasons, including the factors described in Item 1A, Risk Factors in Part II of this Quarterly Report on Form 10-Q. Accordingly, you should not unduly rely on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to publicly revise any forward-looking statements to reflect circumstances or events after the date of this Quarterly Report on Form 10-Q, or to reflect the occurrence of unanticipated events. You should, however, review the factors and risks we describe in the reports we will file from time to time with the SEC after the date of this Quarterly Report on Form 10-Q.

Forward-looking statements include, but are not limited to, statements about:

- our anticipated future results of operations and operating cash flows;
- our business strategies and investment policies;
- our financing plans and the availability of short-term borrowing;
- our competitive position and the effects of competition on our business;
- potential growth opportunities available to us;
- the recruitment and retention of our employees;
- our expected levels of compensation for our employees;
- our potential operating performance, achievements, efficiency and cost reduction efforts;
- our expected tax rate;
- changes in interest rates;
- our expectation with respect to the economy, capital markets, the market for asset management services and other industry trends;
- the benefits to our business resulting from the effects of the reorganization we consummated on October 30, 2007; and
- the impact of future legislation and regulation, and changes in existing legislation and regulation, on our business.

Our Registration Statement on Form S-1 (File No. 333-143660) and the subsequent reports that we file with the SEC, accessible on the SEC s website at www.sec.gov, identify additional factors that can affect forward-looking statements.

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

Pzena Investment Management, LLC and Subsidiaries

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(in thousands)

	December 31, 2006	September 30, 2007 (unaudited)
ASSETS		
Cash and Cash Equivalents	$ 30,920	$ 30,091
Restricted Cash	2,014	2,074
Due from Broker	882	30
Advisory Fees Receivable	25,216	26,430
Investments In Marketable Securities, at Fair Value	23,247	30,224
Receivable From Related Parties	602	349
Other Receivables	1,016	1,179
Investments In Affiliates	3,613	3,610
Prepaid Expenses and Other Assets	360	2,604
Property and Equipment, Net of Accumulated Depreciation of $1,044 and $1,302, Respectively	1,876	3,144
TOTAL ASSETS	$ 89,746	$ 99,735
LIABILITIES AND MEMBERS EQUITY		
Liabilities:		
Accounts Payable and Accrued Expenses	$ 4,082	$ 19,190
Securities Sold Short, at Fair Value	876	944
Due to Broker	2,774	34
Compensatory Units Subject to Mandatory Redemption	263,980	
Long Term Debt		60,000
Other Liabilities	1,048	1,198
Subtotal	272,760	81,366
Capital Units Subject to Mandatory Redemption	533,553	
TOTAL LIABILITIES	806,313	81,366
Commitments and Contingencies		
Minority and Non-controlling Interests	13,399	17,617
Excess of Liabilities over Assets	(729,966)	
Members Equity:		

Members Capital (64,037,910 units issued and outstanding at September 30, 2007)		765,299
Retained Deficit		(764,547)
TOTAL MEMBERS EQUITY	(729,966)	752
TOTAL LIABILITIES AND MEMBERS EQUITY	$ 89,746	$ 99,735

See accompanying notes to financial statements

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Pzena Investment Management, LLC and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, unaudited)

	For the Three Months Ended September 30, 2006	For the Three Months Ended September 30, 2007	For the Nine Months Ended September 30, 2006	For the Nine Months Ended September 30, 2007
REVENUE	$ 29,388	$ 40,217	$ 81,198	$ 112,355
EXPENSES				
Compensation and Benefits Expense	18,490	8,807	56,868	121,213
General and Administrative Expenses	1,723	2,958	5,291	7,587
TOTAL OPERATING EXPENSES	20,213	11,765	62,159	128,800
Operating Income/(Loss)	9,175	28,452	19,039	(16,445)
Interest Income/(Expense), Net	136	(409)	451	156
Dividend Income, Net	183	187	413	458
Realized and Unrealized Gain/(Loss), Net on Marketable Securities and Securities Sold Short	1,455	(1,218)	2,250	(263)
Equity in Earnings/(Loss) of Affiliates	553	(148)	374	(3)
Other	(57)	(33)	(196)	(8)
Total Other Income/(Loss)	2,270	(1,621)	3,292	340
INCOME/(LOSS) BEFORE INCOME TAXES AND MINORITY AND NON-CONTROLLING INTERESTS	11,445	26,831	22,331	(16,105)
Provision for Income Taxes	1,058	1,269	3,072	3,876
Minority and Non-Controlling Interests	720	(711)	1,323	(74)
Income/(Loss) Before Interest on Mandatorily Redeemable Units	9,667	26,273	17,936	(19,907)
Less: Interest on Mandatorily Redeemable Units	11,314		46,751	16,575
NET INCOME/(LOSS)	$ (1,647)	$ 26,273	$ (28,815)	$ (36,482)

See accompanying notes to financial statements

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Pzena Investment Management, LLC and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands, unaudited)

	For the Three Months Ended September 30, 2006	For the Three Months Ended September 30, 2007	For the Nine Months Ended September 30, 2006	For the Nine Months Ended September 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES				
Net Income/(Loss)	$ (1,647)	$ 26,273	$ (28,815)	$ (36,482)
Adjustments to Reconcile Net Income/(Loss) to Cash Provided by Operating Activities:				
Depreciation	76	109	212	267
Non-Cash Compensation	6,396		12,990	82,887
Non-Cash Interest on Mandatorily Redeemable Units	6,218		13,868	(2,420)
Realized and Unrealized (Gain)/Loss, Net on Marketable Securities and Securities Sold Short	(1,455)	1,219	(2,250)	264
Minority and Non-Controlling Interests	720	(711)	1,323	(74)
Equity in (Earnings)/Loss of Affiliates and Investment Partnerships	(553)	148	(374)	3
Deferred Income Taxes	108	(48)	213	(42)
Changes in Operating Assets and Liabilities:				
Advisory Fees Receivable	(2,721)	(377)	(3,971)	(1,214)
Due From Broker	(421)	114	519	852
Restricted Cash	116	(23)	95	(60)
Prepaid Expenses and Other Assets	(56)	(1,086)	1,201	(2,238)
Due to Broker	153	(42)	153	(2,740)
Accrued Expenses and Other Liabilities	2,995	6,082	13,338	14,332
Purchases of Marketable Securities and Securities Sold Short	(4,858)	(10,704)	(12,318)	(20,209)
Proceeds From Sale of Marketable Securities and Securities Sold Short	3,254	3,608	10,467	13,051
Net Cash Provided by Operating Activities	8,325	24,562	6,651	46,177
CASH FLOWS FROM INVESTING ACTIVITIES				
Investments in Affiliates			(5,625)	
Investments in Investment Partnerships			5,460	
Receivable from Related Parties	66	7	171	83
Purchases of Property and Equipment	(73)	(81)	(164)	(1,535)
Net Cash Used in Investing Activities	(7)	(74)	(158)	(1,452)
CASH FLOWS FROM FINANCING ACTIVITIES				
Contributions From Members				3,609
Distributions to Members		(68,546)		(113,455)
Debt Proceeds		60,000		60,000

Contributions From Affiliates		1,101		9,750		2,368		11,971
Distributions to Affiliates				(5,612)		(1,036)		(7,679)
Net Cash Provided By/(Used in) Financing Activities		1,101		(4,408)		1,332		(45,554)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	$	9,419	$	20,080	$	7,825	$	(829)
CASH AND CASH EQUIVALENTS Beginning of Period	$	3,817	$	10,011	$	4,969	$	30,920
Effect of Initial Consolidation of Affiliates						442		
Cash and Cash Equivalents Beginning of Period (Adjusted)		3,817		10,011		5,411		30,920
Net Increase/(Decrease) in Cash and Cash Equivalents		9,419		20,080		7,825		(829)
CASH AND CASH EQUIVALENTS End of Period	$	13,236	$	30,091	$	13,236	$	30,091
Supplementary Cash Flow Information:								
Interest Paid	$	5,111	$	61	$	32,899	$	19,056
Income Taxes Paid	$	620	$	1,388	$	2,060	$	4,038

See accompanying notes to financial statements

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Pzena Investment Management, LLC and Subsidiaries

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2007
(in thousands, except for unit amounts)
(unaudited)

	Capital Units	Members Capital	Retained Deficit	Excess of Liabilities Over Assets	Total
Balance at December 31, 2005		$	$	$ (19,669)	$ (19,669)
Net Income Before Interest on Mandatorily Redeemable Units				17,936	17,936
Interest on Mandatorily Redeemable Units				(46,751)	(46,751)
Balance at September 30, 2006		$	$	$ (48,484)	$ (48,484)

	Capital Units	Members Capital	Retained Deficit	Excess of Liabilities Over Assets	Total
Balance at December 31, 2006		$	$	$ (729,966)	$ (729,966)
Net Income Prior to Amendment of Operating Agreement on March 31, 2007				(88,075)	(88,075)
Amortization of Deferred Compensation Prior to Amendment of Operating Agreement on March 31, 2007				1,901	1,901
Reclassification of Liabilities to Capital Units	63,778,720	875,096	(816,140)	816,140	875,096
Net Income Subsequent to Amendment of Operating Agreement on March 31, 2007			51,593		51,593
Amortization of Deferred Compensation Subsequent to Amendment of Operating Agreement on March 31, 2007		49			49
Unit forfeiture	(7,500)				
Option Exercise	266,690	3,609			3,609
Distributions to Members		(113,455)			(113,455)
Balance at September 30, 2007	64,037,910	$ 765,299	$ (764,547)	$	$ 752

See accompanying notes to financial statements

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Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)

Note 1 Organization

Pzena Investment Management, LLC, together with its subsidiaries (the Company), is an investment adviser which is registered under the Investment Advisers Act of 1940 and is headquartered in New York, New York. The Company currently manages assets in ten value-oriented investment strategies across a wide range of market capitalizations in both U.S. and international capital markets.

The Company has consolidated the results of operations and financial condition of the following private investment partnerships as of and for the three and nine-months ended September 30, 2007:

Entity	Type of Entity (Date of Formation)	Ownership at September 30, 2007
Pzena Large Cap Value Fund	Massachusetts Trust (11/1/02)	99.6%
Pzena Large Cap Value Fund II	Massachusetts Trust (8/1/2006)	99.9%
Pzena International Value Service	Delaware Limited Liability Company (12/22/2003)	0.0%
Pzena Global Value Service	Delaware Limited Liability Company (12/22/2003)	0.0%
Pzena Emerging Markets Value Service	Delaware Limited Liability Company (12/28/2006)	89.9%
Pzena Mega Cap Value Fund	Massachusetts Trust (2/23/2007)	99.9%

Pursuant to its Operating Agreement, the Company will continue until December 31, 2026, unless a terminating event, as defined in the Operating Agreement, occurs prior to this date. Members are not liable for repayment, satisfaction or discharge of any debts, liabilities or obligations of the Company, except to the extent of their capital accounts.

Concurrent with the initial public offering of Pzena Investment Management, Inc. on October 30, 2007, the Company s operating agreement was amended and restated such that, among other things, Pzena Investment Management, Inc. became the sole managing member of the Company as of that date. These transactions are described in Note 13.

Note 2 Significant Accounting Policies

Basis of Presentation:

The consolidated financial statements are prepared in conformity with U.S. generally accepted accounting principles and related SEC rules and regulations. The Company s policy is to consolidate all majority-owned subsidiaries in which it has a controlling financial interest and variable interest entities where the Company is deemed to be the primary beneficiary. The Company also consolidates non-variable-interest entities in which it acts as the general partner or managing member. All significant intercompany transactions and balances have been eliminated.

The consolidated financial statements of the Company include the results of operations and financial condition of the Pzena Large Cap Value Fund, the Pzena Large Cap Value Fund II, the Pzena Emerging Markets Value Service, the

Pzena Investment Management Select Fund, LP and the Pzena Mega Cap Value Fund as of, and from, the dates of their formation. Pzena Investment Management Select Fund, LP was consolidated through January 23, 2007, the date of its liquidation. Pursuant to the guidance of Emerging Issues Task Force Issue 04-5, Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights (EITF 04-5), the results of operations of the Pzena International Value Service and the Pzena Global Value Service have been consolidated effective January 1, 2006. All of these entities represent private investment partnerships over which the Company exercises control. Minority and non-

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Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

controlling interests recorded on the consolidated financial statements of the Company includes the non-controlling interests of the outside investors in each of these entities.

The Company acts as the investment manager for four trusts and one offshore investment company, each of which are considered variable-interest entities. Each of these entities are vehicles through which the Company offers its Global Value and/or International Value strategies and each commenced operations in 2006. The Company is not considered the primary beneficiary of any of these entities. Correspondingly, their results of operations and financial condition are not consolidated by the Company. The total net assets of these variable-interest entities were approximately $1,031.0 million at September 30, 2007. The Company is not exposed to losses as a result of its involvement with these entities because it has no direct investment in them.

Investments in private investment partnerships in which the Company has a minority interest and exercises significant influence are accounted for using the equity method. Such investments are reflected on the consolidated statements of financial condition as investments in affiliates and are recorded at the amount of capital reported by the respective private investment partnerships. Such capital accounts reflect the contributions paid to, distributions received from, and the equity earnings of, the private investment partnerships. The earnings of these private investment partnerships are included in equity in earnings of affiliates in the consolidated statements of operations.

Prior to March 31, 2007, the Company s membership units were categorized as either Compensatory or Capital. Because both types of units had features of both debt and equity, the Company accounted for them pursuant to Statement of Financial Accounting Standards No. 123(R), Share-Based Payment (FAS 123(R)), and Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity (FAS 150), as described further below.

Compensatory Units consisted of a series of annual Profits Only Interest and Class C Profits Interest awards made between 2002 and 2006 that were granted to employees and members for services rendered. Through March 31, 2007, the distributions associated with these units, and the subsequent incremental increase or decrease in their redemption value, were accounted for as part of compensation expense on the consolidated statement of operations, as further discussed below. The cumulative liability for redeeming these units at December 31, 2006 is shown in the consolidated statement of financial condition as compensatory units subject to mandatory redemption.

Capital Units included units issued to founders and those purchased by certain employees. Through March 31, 2007, the distributions associated with these units, and the subsequent incremental increase or decrease in their redemption value, were accounted for as part of interest in mandatorily redeemable units on the consolidated statements of operations. The cumulative liability for redeeming these units at December 31, 2006 is shown in the consolidated statements of financial condition as capital units subject to mandatory redemption.

Effective March 31, 2007, the Company amended its Operating Agreement to remove all mandatory redemption provisions. As all of its membership units thereafter had only equity characteristics, neither distributions nor subsequent incremental changes to their value were charged against income from the effective date of the amendment.

Management s Use of Estimates:

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the period. Actual results could differ from those estimates.

Fair Values of Financial Instruments:

The carrying amount of all financial instruments in the consolidated statements of financial condition, including marketable securities, approximate their fair values.

Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

Revenue Recognition:

Revenue, comprised of advisory fee income, is recognized over the period in which investment management services are provided. Advisory fee income includes management fees that are calculated based on percentages of assets under management, generally billed quarterly, either in arrears or advance, depending on their contractual terms. Advisory fee income also includes incentive fees that may be earned by the Company depending on the investment return of the assets under management. Incentive fee arrangements generally entitle the Company to participate, on a fixed-percentage basis, in any returns generated in excess of an agreed-upon benchmark. The Company s participation percentage in such return differentials is then multiplied by assets under management to determine incentive fees. Returns are calculated on an annualized basis over the contract s measurement period, which may extend up to three years. Incentive fees are generally payable annually. Pursuant to the preferred accounting method under Emerging Issues Task Force Issue D-96, Accounting for Management Fees Based on a Formula (EITF D-96), such incentive fee income is recorded at the conclusion of the contractual performance period when all contingencies are resolved.

Unit-based Compensation:

Prior to January 1, 2006, the Company accounted for its unit-based compensation in accordance with the provisions of APB 25, and related interpretations. On January 1, 2006, the Company adopted FAS 123(R), using the modified prospective method, which requires the recognition of the cost of equity-based compensation based on the grant-date fair value of the award. The adoption of FAS 123(R) did not have a material effect on the results of operations or financial condition of the Company.

Until March 31, 2007, compensation expense included the distributions made on Compensatory Units outstanding, as well as the incremental increases or decreases in the redemption values of these units subsequent to their grant date over their vesting period. Distributions are generally paid on the Company s income before non-cash compensation charges. Prior to December 31, 2006, Compensatory Unit redemption values were determined using a formula-based price, based on the member s pro rata share of net fee revenue (as defined in the Operating Agreement) for the four completed fiscal quarters immediately preceding redemption. This portion of the redemption amount was exclusive of any associated accumulated undistributed earnings, which was also required to be paid to members upon redemption. Effective December 31, 2006, these units redemption features were changed from a formula-based plan to a fair-value based plan. As such, the Company recorded a one-time increase in compensation expense related to that modification.

The Operating Agreement was amended as of March 31, 2007 to eliminate the Company s obligation to redeem units under any circumstance. Since all Compensatory Units thereafter had only equity characteristics, neither distributions, nor subsequent incremental changes to these units value, were charged against income subsequent to March 31, 2007. In addition, as of March 31, 2007 the Company accelerated the vesting of all Compensatory Units then subject to vesting. The Company recorded a one-time charge which was associated with this acceleration as of March 31, 2007.

Interest on Mandatorily Redeemable Units:

Until March 31, 2007, interest on mandatorily redeemable units included distributions made on Capital Units outstanding, as well as the incremental increases or decreases in the redemption values of these units. Distributions are generally paid on the Company s income before non-cash compensation charges. Prior to January 1, 2005, Capital Units were redeemable at book value. Accordingly, incremental increases or decreases to book value in those periods were included as a component of interest on mandatorily redeemable units.

Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

Effective January 1, 2005, the Operating Agreement was amended to require that Capital Units be redeemed on the death of a member at a formula-based price based on the member s pro rata share of net fee revenue (as defined in the Operating Agreement) for the four completed fiscal quarters immediately preceding the member s death. This portion of the redemption amount was exclusive of any accumulated undistributed earnings associated with such units, which were also required to be paid to the member s estate. Accordingly, as of this date, any subsequent incremental increases or decreases to this formula-based price, as well as any change in undistributed earnings, were included as a component of interest on mandatorily redeemable units.

Effective December 31, 2006, these units redemption features were changed from a formula-based plan to a fair-value based plan. As such, the Company recorded a one-time increase in interest on mandatorily redeemable units related to that modification.

Effective March 31, 2007, the Operating Agreement was amended to eliminate the Company s obligation to redeem units under any circumstance. Since all Capital Units thereafter had only equity characteristics, neither distributions, nor subsequent incremental changes to these unit s value, were charged against income subsequent to the effective date of the amendment.

Compensatory Units Subject to Mandatory Redemption:

Until the amendment of its Operating Agreement on March 31, 2007, the Company recorded a net liability for its Compensatory Units equal to the accumulated redemption value as of the balance sheet date of all such outstanding units. This liability also included any undistributed earnings attributable to such units.

Prior to December 31, 2006, vested Compensatory Units were required to be redeemed on the death of a member at a formula-based price based on the member s pro rata share of net fee revenue (as defined in the Operating Agreement) for the four completed fiscal quarters immediately preceding the member s death. Effective December 31, 2006, these units redemption provisions were changed from a formula-based plan to a fair-value based plan. As such, the Company recorded a one-time increase in the liability related to that modification.

Effective March 31, 2007, the Company amended its Operating Agreement to remove all mandatory redemption provisions. As of that date, the liability associated with these units was reclassified as equity. Further, as of March 31, 2007, the Company accelerated the vesting of all compensatory units then subject to vesting.

Capital Units Subject to Mandatory Redemption:

Until the amendment of its Operating Agreement on March 31, 2007, the Company recorded a net liability for its Capital Units equal to the accumulated redemption value as of the balance sheet date of all such outstanding units. This liability also included any undistributed earnings attributable to such units.

Prior to January 1, 2005, Capital Units were redeemable at book value. Effective January 1, 2005, the terms of the Company s Operating Agreement were amended to require that Capital Units be redeemed on the death of a member at a formula-based price determined based on the member s pro rata share of net fee revenue (as defined in the Operating Agreement) for the four completed fiscal quarters immediately preceding the member s death. Effective December 31, 2006, these units redemption provisions were changed from a formula-based plan to a fair-value based plan. As such, the Company recorded a one-time increase in the liability related to that modification.

Effective March 31, 2007, the Company amended its Operating Agreement to remove all mandatory redemption provisions. As of that date, the liability associated with these units was reclassified as equity.

Cash and Cash Equivalents and Restricted Cash:

The Company considers all highly-liquid debt instruments with a maturity of three months or less at the time of purchase to be cash equivalents.

Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

Interest on cash and cash equivalents is recorded as interest income on the consolidated statements of operations.

The Company was required to maintain compensating balances of $2.0 million and $2.1 million at December 31, 2006 and September 30, 2007, respectively, as collateral for letters of credit issued by a third party in lieu of a cash security deposit, as required by the Company s lease for its New York office space. Such amounts are included in restricted cash on the consolidated statements of financial condition.

Due From Broker:

Due from broker consists primarily of cash balances and amounts receivable for unsettled securities transactions held at the clearing brokers of the Company s consolidated investment partnerships.

Due To Broker:

Due to broker consists primarily of amounts payable for unsettled securities transactions initiated by the clearing brokers of the Company s consolidated investment partnerships.

Investments in Securities:

Investments in marketable securities and securities sold short represent primarily the securities held by the Company s consolidated investment partnerships. All such securities are classified as trading securities and are recorded at fair value, with net realized and unrealized gains and losses reported in earnings in the consolidated statements of operations.

Securities Valuation:

Investments in marketable equity securities and securities sold short which are traded on a national securities exchange (or reported on the NASDAQ national market) are carried at fair value based on the last reported sales price on the valuation date. If no reported sales occurred on the valuation date, investments in securities are valued at the bid price and securities sold short are valued at the ask price. Securities transactions are recorded on the trade date.

The net realized gain or loss on sales of securities is determined on a specific identification basis and is included in realized and unrealized gain (loss), net on marketable securities and securities sold short in the consolidated statements of operations.

Concentrations of Credit Risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, restricted cash and advisory fees receivable. The Company maintains its cash, temporary cash and restricted cash investments in bank deposit and other accounts whose balances, at times, exceed Federally insured limits.

The concentration of credit risk with respect to advisory fees receivable is generally limited, due to the short payment terms extended to clients by the Company. On a periodic basis, the Company evaluates its advisory fees receivable and establishes an allowance for doubtful accounts, if necessary, based on a history of past write-offs and collections and current credit conditions. For the three months ended September 30, 2006 and 2007, approximately 20.7% and 19.3%, respectively, of the Company s advisory fees were generated from an advisory agreement with one client. For the nine months ended September 30, 2006 and 2007, fees generated from this agreement comprised 19.8% and 21.6%, respectively, of the Company s total advisory fees. At December 31, 2006 and September 30, 2007, no allowance for doubtful accounts has been deemed necessary.

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Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

Property and Equipment:

Property and equipment are carried at cost, less accumulated depreciation and amortization. Depreciation is provided on a straight-line basis over the estimated useful lives of the respective assets, which range from three to seven years. Leasehold improvements are amortized on a straight-line basis over the shorter of the useful life of the improvements or the remaining lease term.

Business Segments:

The Company views its operations as comprising one operating segment.

Income Taxes:

The Company is a limited liability company that has elected to be treated as a partnership for tax purposes. The Company has not made provision for federal or state income taxes because it is the personal responsibility of each of the Company s members to separately report their proportionate share of the Company s taxable income or loss. Similarly, the income of the Company s consolidated investment partnerships is not subject to income taxes, as it is allocated to each partnership s individual partners. The Company has made provision for New York City Unincorporated Business Tax. The Company is a cash basis taxpayer.

The Company accounts for the New York City Unincorporated Business Tax pursuant to the asset and liability method, which requires deferred income tax assets and liabilities to be recorded for temporary differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the periods in which the temporary differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. The income tax provision, or credit, is the tax payable or refundable for the period, plus or minus the change during the period in deferred tax assets and liabilities.

Foreign Currency:

Investment securities and other assets and liabilities denominated in foreign currencies are translated into U.S. dollar amounts at the date of valuation. Purchases and sales of investment securities and income and expense items denominated in foreign currencies are translated into U.S. dollar amounts on the respective dates of such transactions.

The Company does not isolate that portion of the results of its operations resulting from changes in foreign exchange rates on investments from the fluctuations arising from changes in market prices of securities held. Such fluctuations are included in the net realized and unrealized gain/(loss), net on marketable securities and securities sold short.

Reported net realized foreign exchange gains or losses arise from sales of foreign currencies, currency gains or losses realized between the trade and settlement dates on securities transactions, and the difference between the amounts of dividends, interest, and foreign withholding taxes recorded on the Company s books and the U.S. Dollar equivalent of the amounts actually received or paid. Net unrealized foreign exchange gains and losses arise from changes in the fair values of assets and liabilities, other than investments in securities at fiscal period end, resulting from changes in exchange rates.

New Accounting Pronouncements:

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribed the minimum recognition threshold a tax position must meet in connection with accounting for uncertainties in income tax positions taken, or expected to be taken, by an entity before being measured and recognized in the financial

Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

statements. The Company adopted FIN 48 on January 1, 2007. The impact of the adoption of this standard was not material.

In September 2006, the FASB released Statement of Financial Accounting Standards No. 157, Fair Value Measurements (FAS 157). FAS 157 establishes an authoritative definition of fair value, sets out a framework for measuring fair value, and requires additional disclosures about fair-value measurements. The application of FAS 157 is required for fiscal years beginning after November 15, 2007. Management is in the process of assessing the impact of this standard on the consolidated financial statements of the Company.

In June 2007, the American Institute of Certified Public Accountants issued Statement of Position No. 07-1, Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies (SOP 07-1). SOP 07-1 clarifies the definition of an investment company and whether the specialized accounting model of an investment company may be retained by a parent company in consolidation or by an investor in the application of the equity method of accounting. SOP 07-1 will be effective for reporting periods beginning on or after December 15, 2007. The Company is currently evaluating the potential impact of the adoption of SOP 07-1 on its consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 permits an entity to elect to measure certain financial instruments and certain other items at fair value with changes in fair value recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the potential impact of the adoption of SFAS 159 on its consolidated financial statements.

Note 3 Property and Equipment

Property and equipment, net, are comprised of the following:

	December 31, 2006	September 30, 2007
	(in thousands)	
Computer Hardware	$ 682	$ 789
Computer Software	141	144
Furniture and Fixtures	775	1,156
Office Equipment	189	243
Leasehold Improvements	1,133	2,114
Total	2,920	4,446
Less: Accumulated Depreciation and Amortization	(1,044)	(1,302)
Total	$ 1,876	$ 3,144

Depreciation and amortization expense, included in general and administrative expenses, totaled $0.1 million and $0.1 million for the three months ended September 30, 2006 and 2007, respectively. Such expenses totaled $0.2 million and $0.3 million for the nine months ended September 30, 2006 and 2007, respectively.

Note 4 Related Party Transactions

For the three and nine months ended September 30, 2007, the Company earned $2.1 million and $5.6 million, respectively, in investment advisory fees from unconsolidated entities in which it has an ownership interest and for which it acts as the investment manager. For the three and nine months ended September 30, 2006, such advisory fees totaled $0.8 million and $1.4 million, respectively.

Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

At December 31, 2006 and September 30, 2007, the Company had advanced $0.1 million to an international investment company for organization and start-up costs, which are included in receivable from related parties on the consolidated statements of financial condition. The Company is the sponsor and investment manager of this entity.

At December 31, 2006 and September 30, 2007, receivable from related parties included $0.5 million and $0.2 million, respectively, of loans to employees. Certain of these loans are in the form of forgivable promissory notes which are amortized through compensation expense pursuant to their terms.

Employees of the Company who are considered accredited investors have the ability to open separately-managed accounts, or invest in certain of the Company s consolidated investment partnerships, without being assessed advisory fees. Investments by employees in separately-managed accounts are permitted only at the discretion of the Executive Committee, but are generally not subject to the same minimum investment levels that are required of outside investors. Some of the investment advisory fees that are waived on separately managed accounts for employees are for strategies that typically have account minimums, which vary by strategy, but typically average approximately $50,000 per account per year. The impact of this benefit is not material to the Company s consolidated financial statements for any period presented.

Note 5 Investments in Affiliates

The Company holds investments in, and acts as manager of, an unconsolidated investment partnership which is accounted for under the equity method. Summary financial information related to this entity is as follows:

	PAI Hedged Value Fund, LLC (in thousands)	
	December 31, 2006	September 30, 2007
Investments, at Fair Value	$ 12,277	$ 13,106
Total Liabilities	(12)	(18)
Net Assets	$ 12,265	$ 13,088
Equity Held by the Company	$ 3,613	$ 3,610
Ownership Percentage	29%	28%

	PAI Hedged Value Fund, LLC The Three Months Ended September 30, (in thousands)	
	2006	2007

Net Investment Income	$	31	$	10
Net Realized and Unrealized Income (Loss)		991		(547)
Net Income (Loss)	$	1,022	$	(537)
Company s Equity in Earnings/(Loss)	$	553	$	(148)

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Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

	PAI Hedged Value Fund, LLC The Nine Months Ended September 30,	
	2006	2007
	(in thousands)	
Net Investment Income	$ 20	$ 1
Net Realized and Unrealized Income (Loss)	673	(49)
Net Income (Loss)	$ 693	$ (48)
Company s Equity in Earnings/(Loss)	$ 374	$ (3)

Note 6 Commitments and Contingencies

In the normal course of business, the Company enters into agreements that include indemnities in favor of third parties, such as engagement letters with advisors and consultants. In certain cases, the Company may have recourse against third parties with respect to these indemnities. The Company maintains insurance policies that may provide coverage against certain claims under these indemnities. FASB issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45), providing accounting and disclosure requirements for certain guarantees. The Company has had no claims or payments pursuant to these agreements, and it believes the likelihood of a claim being made is remote. Utilizing the methodology in FIN 45, the Company s estimate of the value of such guarantees is de minimis, and, therefore, an accrual has not been made in the consolidated financial statements.

In the normal course of business, the Company may also be subject to various legal proceedings from time to time. Currently, there are no such proceedings pending against the Company.

The Company leases office space under a non-cancelable operating lease agreement which expires on October 31, 2015. The Company reflects lease expense over the lease term on a straight-line basis. In early 2007, the Company agreed to lease additional office space at the Company s headquarters at 120 West 45th Street, New York, New York. The Company took possession of this space on March 1, 2007. The new lease is co-terminus with the Company s existing lease.

Lease expenses for the three months ended September 30, 2006 and 2007 were $0.3 million and $0.5 million, respectively. Such expenses totaled $0.9 million and $1.2 million for the nine months ended September 30, 2006 and 2007, respectively.

Note 7 Retirement Plan

The Company maintains a defined contribution pension plan which covers substantially all members and employees. The Company may make contributions to the plan at the discretion of management. Under the terms of the plan, all such contributions vest immediately. Company contributions for the three months ended September 30, 2006 and 2007 were $0.3 million and $0.4 million, respectively. Such contributions totaled $0.8 million and $1.1 million for the nine months ended September 30, 2006 and 2007, respectively.

Note 8 Compensation

As discussed further in Note 12, the Company issued Compensatory Units to employees and members which had redemption features that required them to be classified as liabilities in the consolidated statements of financial condition. Prior to March 31, 2007, distributions on the Compensatory Units outstanding, and changes in these units redemption values, were recorded as compensation expense. Effective December 31, 2006, the terms of these units redemption features were changed from a formula-based plan to a fair-value based plan.

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Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

As of March 31, 2007, the effective date of the amendment to the Operating Agreement to eliminate the Company s obligation to redeem units under any circumstance, the unit-based compensation awards previously categorized as liabilities were reclassified as equity. Further, as of March 31, 2007, the Company accelerated the vesting of all Compensatory Units then subject to vesting. Subsequent to this date, distributions on these units are not considered a component of compensation expense and are instead recorded as a direct reduction of members capital.

Compensation and benefits expense to employees and members is comprised of the following:

	For the Three Months Ended September 30,	
	2006	2007
	(in thousands)	
Cash Compensation and Benefits	$ 8,802	$ 8,807
Distributions on Compensatory Units	3,292	
Change in Redemption Value of Compensatory Units	6,396	
Other Non-Cash Compensation		
Total Compensation and Benefits Expense	$ 18,490	$ 8,807

	For the Nine Months Ended September 30,	
	2006	2007
	(in thousands)	
Cash Compensation and Benefits	$ 26,020	$ 26,239
Distributions on Compensatory Units	17,858	12,087
Change in Redemption Value of Compensatory Units	12,990	15,969
Acceleration of Vesting of Compensatory Units		64,968
Other Non-Cash Compensation		1,950
Total Compensation and Benefits Expense	$ 56,868	$ 121,213

Note 9 Long Term Debt and Credit Facility

On July 23, 2007, the Company entered into a $60.0 million, three-year term loan agreement, the proceeds of which were used to finance a one-time distribution to current members. The principal amount borrowed bears interest at a variable rate based, at the Company s option, on (1) the one, two, three, six, nine or twelve-month LIBOR Market

Index Rate plus 1.00%, or (2) the higher of the lender s prime rate and the Federal Funds Rate. The principal amount is payable in full at the end of the three-year term, with no penalty for prepayment. For the year ended July 23, 2008, the interest rate in effect will be 6.41%, which is equal to the twelve-month LIBOR rate in effect at the time of the closing of the agreement of 5.41% plus 1.00%. Approximately $0.1 million in debt issuance costs were incurred associated with this loan. Such costs have been recorded in prepaid expenses and other assets and will be amortized over the term of the loan as a component of other income on the consolidated statements of operations.

Also on July 23, 2007, the Company obtained a $20.0 million revolving credit facility, which will expire on July 23, 2010, in order to finance its short term working capital needs. This facility carries a commitment fee of 0.2% on any unused amounts. As of and for the period ended September 30, 2007, no balance was outstanding against the facility.

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Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

Note 10 Income Taxes

The provision for New York City Unincorporated Business Tax is comprised of the following:

	The Three Months Ended September 30, 2006	2007
	(in thousands)	
Current	$ 950	$ 1,317
Deferred	108	(48)
Total	$ 1,058	$ 1,269

	The Nine Months Ended September 30, 2006	2007
	(in thousands)	
Current	$ 2,859	$ 3,918
Deferred	213	(42)
Total	$ 3,072	$ 3,876

Deferred tax liabilities of $1.0 million and $0.9 million are included in other liabilities at December 31, 2006 and September 30, 2007, respectively. Deferred tax liabilities are primarily the result of the Company s use of the cash basis of accounting for income taxes.

The income tax provision differs from the expense that would result from applying the New York City Unincorporated Business Tax rate to income before income taxes. The primary difference results from members compensation, which is not deductible for tax purposes.

Note 11 Investments in Marketable Securities

Marketable securities and securities sold short consisted of the following at December 31, 2006:

Unrealized

	Cost	Gain/(Loss) (in thousands)	Fair Value
Equities	$ 20,828	$ 2,419	$ 23,247

	Proceeds	Unrealized (Gain)/Loss (in thousands)	Fair Value
Equity Securities Sold Short	$ 681	$ 195	$ 876

Marketable securities consisted of the following at September 30, 2007:

	Cost	Unrealized Gain/(Loss) (in thousands)	Fair Value
Equities	$ 29,186	$ 1,038	$ 30,224

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Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

	Proceeds	Unrealized (Gain)/Loss	Fair Value
		(in thousands)	
Equity Securities Sold Short	$ 941	$ 3	$ 944

Note 12 Members Equity Interests

Prior to December 31, 2006, ownership interests in the Company were comprised of Capital Units (Class A Voting Units and Class B Non-Voting Units), and various series of Profits-Only Interests and Class C Profits Interests. With the exception of the Class B Non-Voting Units, all units were entitled to vote. All of the Profits-Only Interests and Class C Profits Interests were granted to employees and members as unit-based compensation. Profits-Only Interests vested ratably over a three-year period, while the Class C Profits Interests cliff vested at the conclusion of their three-year term. Profits and losses were allocated on a pro rata basis according to the terms of the Operating Agreement. Effective January 1, 2005, the Operating Agreement was amended to require that all Capital Units be repurchased in the event of the holder s death or, if applicable, termination of employment, at a formula-based price, determined by the holder s pro rata share of net fee revenue (as defined in the Operating Agreement) for the four completed fiscal quarters immediately preceding the holder s death or, if applicable, the holder s termination of employment. Profits-Only Interests and Class C Profits Interests had similar repurchase provisions effective from their respective dates of grant. These redemption amounts were exclusive of any accumulated undistributed earnings associated with such units, which were also required to be paid to the holder s estate. Prior to this amendment, all Capital Units were required to be repurchased at their book value at the time of the unitholder s death. These redemption features caused all of the Company s units to be classified as liabilities as of the effective date of FAS 150 with respect to the Company, which was July 1, 2003.

Prior to March 31, 2007, distributions made with respect to Compensatory Units were classified as compensation expense. Incremental changes to these units redemption values subsequent to the grant date were also included as a component of compensation expense at each reporting period. For the Company s non-compensatory units (Capital Units), distributions and incremental changes in the net liability associated with these units redemption values have been recorded as components of interest on mandatorily redeemable units in the consolidated statements of operations for all periods prior to March 31, 2007.

Upon a sale of the Company, proceeds were to be allocated first to the holders of Capital Units, and then to the holders of Profits-Only Interests and Class C Profits Interests based on their pro rata share of the incremental increase in assigned value of the Company above the point at which the respective units were issued.

On December 31, 2006, the Company initiated a capital restructuring, wherein all of the outstanding Compensatory Units and Capital Units were exchanged for new units on a percentage basis determined by the outstanding units relative fair values. These new units all retained the same earnings sharing and voting rights, but participate in the potential liquidation of the Company on a pro rata basis. The Company and unitholders each had fair-value put and call provisions, subject to certain restrictions, that allowed for redemption only for vested units that have been held longer than six months. New units exchanged for units previously issued retained their original liability classification.

Of the total $696.3 million increase in value arising from the change from a formula-based redemption plan to a fair-value plan, approximately $232.5 million was associated with compensatory unit awards and charged to compensation expense on December 31, 2006. The remaining $463.8 million was recorded as a component of interest on mandatorily redeemable units for the year ended December 31, 2006.

The Operating Agreement was amended as of March 31, 2007 to eliminate the Company s obligation to redeem units under any circumstance. As a result, all units that were categorized as liabilities in the Company s consolidated financial statements were reclassified as equity as of March 31, 2007. Subsequent to this date, distributions paid on unit-based compensation and incremental changes to these units value are not considered a component of compensation expense and are instead recorded as a direct reduction of undistributed earnings. As of

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Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

March 31, 2007, the Company accelerated the vesting of all Compensatory Units then subject to vesting. The one-time charge associated with this acceleration, approximately $65.0 million, was recorded on March 31, 2007.

Capital Units, all subject to mandatory redemption upon the death of the holders, consisted of:

	As of December 31, 2006 (in thousands)	
Members Capital (39,891,000 units issued and outstanding at December 31, 2006)	$	18,383
Undistributed Loss Attributable to Capital Units		(214,796)
Excess of Redemption Amount Over Capital and Undistributed Loss		729,966
Total	$	533,553

Compensation expense associated with the Company s Compensatory Units, consisting of Profits-Only Interests and Class C Profits Interests, is comprised of the following:

	For the Three Months Ended September 30, (in thousands)			
	2006		2007	
Distributions on Compensatory Units	$	3,292	$	
Change in Redemption Value of Compensatory Units		6,396		
Acceleration of Vesting of Compensatory Units				
Total Unit-Based Compensation Expense	$	9,688	$	

	For the Nine Months Ended September 30, (in thousands)			
	2006		2007	
Distributions on Compensatory Units	$	17,858	$	12,087
Change in Redemption Value of Compensatory Units		12,990		15,969
Acceleration of Vesting of Compensatory Units				64,968

Total Unit-Based Compensation Expense	$ 30,848	$ 93,024

In 2007, the Company granted 129,000 options to purchase Capital Units to certain employees and members pursuant to the Pzena Investment Management, LLC 2006 Equity Incentive Plan. These options vest ratably over a four-year period and were issued at a strike price of $13.53, which was equal to the assessed fair market value per unit at the time of award issuance. The Company determined that the total grant-date fair value of these options was approximately $2.0 million, using the Black-Scholes option pricing model with the following assumptions:

Weighted-average Time Until Exercise:	7 years
Volatility:	30%
Risk Free Rate:	5.22%
Dividend Yield:	4.87%

For the nine months ended September 30, 2007, the Company recognized approximately $2.0 million in other non-cash compensation expense associated with the accelerated amortization of the grant-date fair value of these options.

Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

The following is a summary of the option activity for the nine months ended September 30, 2007:

	Options Outstanding	Weighted Average Exercise Price
Balance at January 1, 2007		$
Options Granted	645,000	13.53
Options Cancelled	(20,000)	(13.53)
Options Exercised	(266,690)	(13.53)
Balance at September 30, 2007	358,310	13.53

The weighted-average grant date fair value of options issued in 2007 was $13.53.

Except as otherwise provided by law, the liability of a member of the Company is limited to the amount of its capital account. A member may transfer or assign all, or any part of, its membership interest to any other party (a Transferee). A Transferee of such membership interest shall not become a member unless its membership in the Company is unanimously approved by the then existing member(s) in writing. Any Transferee admitted as a member shall succeed to the capital account or portion thereof transferred or assigned, as if no such transfer or assignment had occurred.

On February 13, 2007, the Company accelerated the vesting of 285,000 of the 315,500 Class A Voting Units that were granted on January 1, 2007 pursuant to its 2006 Equity Incentive Plan and repurchased them from a departing employee. The charge associated with this acceleration was approximately $3.8 million and has been included in compensation expense for the nine months ended September 30, 2007.

In 2003, the Company issued immediately vested options to purchase Capital Units to a member, exercisable at various prices and expiring in September 2013. In each of January 2004, 2005 and 2006, the terms of the grant were amended to adjust for the dilutive effect of the issuance of additional members equity interests. The Company accounted for these options using the intrinsic value method prescribed by APB 25. No compensation cost associated with these grants and their subsequent modifications has been reflected in net income, as all such options had exercise prices in excess of fair market value on the date of grant or modification. If the Company had recorded compensation cost for these options based on the fair value of the options on the date of grant consistent with FAS 123(R), the impact on the Company s net income would not have been material.

On January 1, 2006, the Company effected a 600-for-1 unit split. On July 17, 2007, the Company effected an additional 5-for-1 unit split. All unit and per unit amounts have been adjusted to reflect these splits.

Note 13 Subsequent Events

On October 30, 2007, Pzena Investment Management, Inc. consummated an initial public offering of 6,100,000 shares of its Class A common stock, par value $0.01 per share, for net proceeds of approximately $99.1 million, after payment of underwriting discounts and estimated offering expenses. These net proceeds were used to purchase 6,100,000 membership units of the Company, representing 9.5% of the then outstanding membership units of the Company, from two outside investors and one former employee of the Company. Concurrently with the consummation of Pzena Investment Management, Inc. s initial public offering, the operating agreement of the Company was amended and restated such that, among other things, Pzena Investment Management, Inc. became the sole managing member of the Company. The acquisition of the Company s membership interests by Pzena Investment Management, Inc. will be treated as a reorganization of entities under common control pursuant to the guidance set forth in Financial Accounting Standards Board Technical Bulletin No. 85-5, Issues Relating to Accounting for Business Combinations (FTB 85-5). Accordingly, the net assets assumed by Pzena Investment Management, Inc. through the offering will be reported at the Company s historical cost basis. As a result of these transactions, as of and subsequent to October 30, 2007, (i) Pzena Investment Management, Inc. will consolidate the financial results of the Company with its own and reflect the 90.5% membership interest in the

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Pzena Investment Management, LLC and Subsidiaries

Notes to Consolidated Financial Statements (unaudited) (Continued)

Company it does not own as a non-controlling interest in its consolidated financial statements, and (ii) Pzena Investment Management, Inc. s income will be generated by its 9.5% economic interest in the Company s net income.

In connection with the reorganization and initial public offering, the Company made a distribution of approximately $18.5 million on October 19, 2007, which represented all of the remaining undistributed earnings generated through the consummation of the transactions, less any amounts required to fund working capital needs.

On November 21, 2007, a putative class action lawsuit was commenced in the United States District Court for the Southern District of New York against Pzena Investment Management, Inc. and Richard S. Pzena, its chief executive officer, seeking remedies under Section 11 of the Securities Act of 1933, as amended. The complaint alleges that the registration statement and prospectus relating to the initial public offering of the Class A common stock of Pzena Investment Management, Inc. contained materially misleading statements and otherwise failed to disclose a pattern of net redemptions in the John Hancock Classic Value Fund for which the Company acts as sub-investment advisor (which is a portion of Pzena Investment Management, Inc. s Large Cap Value investment strategy). The plaintiff seeks to represent a class of all persons who purchased or otherwise acquired Class A common stock in the initial public offering and seeks damages in an unspecified amount. Pzena Investment Management, Inc. believes that the allegations and claims against it and its chief executive officer are without merit and it intends to contest these claims vigorously.

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Pzena Investment Management, Inc.

STATEMENTS OF FINANCIAL CONDITION

	May 10, 2007 (capitalization)		September 30, 2007 (unaudited)	
ASSETS				
Cash	$	100	$	100
TOTAL ASSETS	$	100	$	100
STOCKHOLDER S EQUITY				
Common Stock ($0.01 par value, 1,000 shares authorized, 6 shares issued and outstanding)	$	0	$	0
Additional Paid-in Capital		100		100
Retained Earnings				
TOTAL STOCKHOLDER S EQUITY	$	100	$	100

See accompanying notes to financial statements

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Pzena Investment Management, Inc.

STATEMENT OF OPERATION
(unaudited)

	For the Three Months Ended September 30, 2007	For the Period May 10, 2007 (capitalization) through September 30, 2007
REVENUE	$	$
EXPENSES		
NET INCOME	$	$
Basic and Diluted Net Income Per Share	$	$
Weighted Average Shares Used in Basic and Diluted Net Income Per Share	6	6

See accompanying notes to financial statements

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Pzena Investment Management, Inc.

STATEMENT OF CASH FLOWS
(unaudited)

	For the Three Months Ended September 30, 2007	For the Period May 10, 2007 (capitalization) through September 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$	$
Adjustments to Reconcile Net Income to Cash Flows Provided by Operating Activities		
Changes in Operating Assets and Liabilities		
Net Cash Provided by Operating Activities		
CASH FLOWS FROM INVESTING ACTIVITIES		
Investing Activities		
Net Cash Provided by Investing Activities		