

DIAMOND HILL INVESTMENT GROUP INC

Form 10-K

February 25, 2011

Table of Contents

**United States Securities and Exchange Commission
Washington, D.C. 20549
Form 10-K**

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

For the fiscal year ended December 31, 2010

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

614-255-3333

(Address of principal executive offices) (Zip Code)

(Registrant's telephone number)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

Common shares, no par value

The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Aggregate market value of the registrant's common shares (the only common equity of the registrant) held by non-affiliates of the registrant, based on the closing price of \$56.69 on June 30, 2010 on the NASDAQ Global Select

Market was \$128,451,944. Calculation of holdings by non-affiliates is based upon the assumption, for these purposes only, that the registrant's executive officers and directors and persons holding five percent or more of the registrant's common shares are affiliates.

2,798,729 Common Shares outstanding as of February 17, 2011.

Documents incorporated by reference: Portions of the registrant's definitive proxy statement for the 2011 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, are incorporated by reference into Part III of this report.

Diamond Hill Investment Group, Inc.
Form 10-K
For the Fiscal Year Ended December 31, 2010
Index

Required Information	Page
<u>Part I</u>	
<u>Item 1. Business</u>	3
<u>Item 1A. Risk Factors</u>	8
<u>Item 1B. Unresolved Staff Comments</u>	9
<u>Item 2. Properties</u>	9
<u>Item 3. Legal Proceedings</u>	9
<u>Item 4. (Removed and Reserved)</u>	9
<u>Part II</u>	
<u>Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	10
<u>Item 6. Selected Financial Data</u>	12
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	12
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	20
<u>Item 8. Financial Statements and Supplementary Data</u>	21
<u>Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosures</u>	35
<u>Item 9A. Controls and Procedures</u>	35
<u>Item 9B. Other Information</u>	36
<u>Part III</u>	
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	36
<u>Item 11. Executive Compensation</u>	36
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	36

<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	37
<u>Item 14. Principal Accounting Fees and Services</u>	37
<u>Part IV</u>	
<u>Item 15. Exhibits, Financial Statement Schedules</u>	38
<u>Signatures</u>	39
<u>Exhibit 10.4</u>	
<u>Exhibit 21.1</u>	
<u>Exhibit 23.1</u>	
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	
<u>Exhibit 32.1</u>	

Table of Contents**PART I****Item 1. Business****Forward-Looking Statements**

Throughout this Annual Report on Form 10-K, Diamond Hill Investment Group, Inc. (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 for achieving the critical threshold of assets under management, technological developments, economic trends (including interest rates and market volatility), expected transactions and acquisitions and similar matters. The words believe, expect, anticipate, estimate, should, hope, seek, plan, intend and similar words identify forward-looking statements that speak only as of the date thereof. While the Company believes that the assumptions underlying its forward-looking statements are reasonable, investors are cautioned that any of the assumptions could prove to be inaccurate and accordingly, the actual results and experiences of the Company could differ materially from the anticipated results or other expectations expressed by the Company in its forward-looking statements. Factors that could cause such actual results or experiences to differ from results discussed in the forward-looking statements include, but are not limited to: the adverse effect from a decline in the securities markets; a decline in the performance of the Company's products; changes in interest rates; a general or prolonged downturn in the economy; changes in government policy and regulation, including monetary policy; changes in the Company's ability to attract or retain key employees; unforeseen costs and other effects related to legal proceedings or investigations of governmental and self-regulatory organizations; and other risks identified from time-to-time in the Company's other public documents on file with the U. S. Securities and Exchange Commission (SEC), including those discussed below in Item 1A.

General

The Company, an Ohio corporation organized in April 1990, derives its consolidated revenue and net income from investment advisory and fund administration services provided by its subsidiaries Diamond Hill Capital Management, Inc. (DHCM), Beacon Hill Fund Services, Inc. (BHFS), and BHIL Distributors, Inc. (BHIL). BHFS and BHIL collectively operate as Beacon Hill. DHCM is a registered investment adviser under the Investment Advisers Act of 1940 providing investment advisory services to individuals and institutional investors through Diamond Hill Funds, separate accounts, and private investment funds (generally known as hedge funds). Beacon Hill was incorporated during the first quarter of 2008, and provides certain fund administration services and underwriting services to mutual fund companies, including Diamond Hill Funds.

The Company's primary objective is to fulfill its fiduciary duty to clients through a disciplined intrinsic value approach to investing. Its secondary objective is to achieve an adequate long-term return for shareholders.

The Company sponsors, markets, and provides investment advisory and related services to various clients including mutual funds, separate accounts, and private investment funds. The Company's principal source of revenue is investment advisory fee income earned pursuant to investment advisory contracts with its clients. This fee income is based primarily upon the net assets of the funds or separate accounts. The Company's investment advisory revenue depends largely on the total value and composition of assets under management (AUM). Accordingly, fluctuations in financial markets and in the composition of AUM impact our revenues and results of operations.

Investment Advisory Activities

DHCM executes its investment strategies through fundamental research and valuation disciplines. DHCM's analysts evaluate a company's prospects based upon its current business and financial position, future growth opportunities, and management capability and strategy. The intended result is an estimate of intrinsic value. Intrinsic value is the present value of estimated future cash flows, discounted at a rate that reflects the required return for the investment given the estimated level of risk. In other words, it is the estimated price a minority shareholder should pay in order to achieve a satisfactory or fair return on the investment. The estimate of intrinsic value is then compared to the current market price to evaluate whether, in the opinion of DHCM, an attractive investment opportunity exists. A proprietary valuation model, which takes into account projected cash flows for five years including a terminal value (the expected stock price in five years), assists in many of these intrinsic value estimations. DHCM also applies an intrinsic value philosophy to the analysis of fixed income securities.

Table of Contents

DHCM believes that although securities markets are competitive, pricing inefficiencies often exist allowing for attractive investment opportunities. Furthermore, DHCM believes that investing in securities whose market prices are significantly below DHCM's estimate of intrinsic value (or selling short securities whose market prices are above DHCM's estimate of intrinsic value) is a reliable method to achieve above average relative returns as well as mitigate risk.

Current portfolio strategies managed by DHCM include Small Cap, Small-Mid Cap, Large Cap, Select, Long-Short, Financial Long-Short, and Strategic Income. These strategies are available on a separately managed basis and/or through a mutual fund. The Long-Short strategy is also available through private investment funds that are offered to accredited and qualified investors in the United States and around the world. The Company believes its desire to grow AUM should never come before its fiduciary obligation to clients. Once the Company determines that the size of any of its strategies hinders its ability to either differentiate its product or add value for its clients, the Company will close those strategies to new clients, which may impact the Company's ability to grow AUM. The Small Cap strategy was closed to new investors as of December 31, 2005 and re-opened on September 1, 2007. The Long-Short strategy was closed to new investors as of June 30, 2008 and re-opened on December 31, 2008.

Marketing

DHCM primarily generates business for all three of its product lines (mutual funds, separately managed accounts, and private investment funds) through wholesaling to financial intermediaries, including independent registered investment advisors, brokers, financial planners, investment consultants and third party marketing firms. In addition, DHCM recently began to actively market its separately managed accounts directly to institutional plan sponsors.

Assets Under Management

As of December 31, 2010, AUM totaled \$8.6 billion, a 37% increase from December 31, 2009. The following tables show AUM by product and investment objective for the dates indicated and a roll-forward of the change in AUM for the years ended December 31, 2010, 2009, and 2008:

(in millions)	Assets Under Management by Product		
	As of December 31,		
	2010	2009	2008
Mutual funds	\$ 4,198	\$ 3,494	\$ 3,010
Sub-advised mutual funds	930	146	104
Separate accounts	3,284	2,423	1,175
Private investment funds	211	220	221
Total AUM	\$ 8,623	\$ 6,283	\$ 4,510

Table of Contents

(in millions)	Assets Under Management by Investment Objective As of December 31,		
	2010	2009	2008
Small Cap	\$ 948	\$ 625	\$ 403
Small-Mid Cap	196	146	102
Large Cap	4,631	2,654	1,266
Select	422	400	258
Long-Short	2,251	2,300	2,331
Strategic Income	175	158	150
Total AUM	\$ 8,623	\$ 6,283	\$ 4,510

(in millions)	Change in Assets Under Management For the Year Ended December 31,		
	2010	2009	2008
AUM at beginning of the year	\$ 6,283	\$ 4,510	\$ 4,403
Net cash inflows (outflows) mutual funds	467	(109)	1,328
sub-advised mutual funds	714	6	54
separate accounts	532	734	757
private investment funds	(15)	(52)	(162)
	1,698	579	1,977
Net market appreciation (depreciation) and income	642	1,194	(1,870)
Increase during the year	2,340	1,773	107
AUM at end of the year	\$ 8,623	\$ 6,283	\$ 4,510

Diamond Hill Funds

The Diamond Hill Funds (the Funds) are used by over 5,000 financial representatives at over 1,400 financial intermediary firms. Below is a summary of the assets by distribution channel as of December 31, 2010, 2009, and 2008:

(in millions)	Diamond Hill Funds Assets by Distribution Channel As of December 31,		
	2010	2009	2008
Registered investment advisors	\$ 1,080	\$ 1,272	\$ 1,197
Independent broker/dealers	815	757	781
Wirehouse broker/dealers	775	824	645
Defined contribution and banks	1,290	254	166
Other	183	345	188
Total	\$ 4,143	\$ 3,452	\$ 2,977

Sub-advised mutual funds

DHCM increased its sub-advised mutual funds relationships during 2010, which increase AUM by \$784 million compared to 2009. Sub-advised mutual funds are registered investment companies, where DHCM manages an allocated portion of the fund and has limited distribution responsibilities.

Institutional Accounts

DHCM continues to develop institutional relationships for separately managed accounts primarily through consultant relationships and database research screens. During 2010 and 2009, DHCM added additional resources to focus on further developing its relationships with institutional consultants and plan sponsors.

Table of Contents

Growth Prospects

DHCM's investment strategies have produced long-term investment returns that the Company views as strong and believes compare very favorably to competitors. Investment returns have been a key driver in the success the Company has achieved in growing AUM.

As a result, the Company has continued to invest in marketing throughout 2010 in an effort to expand distribution. Such expenditures included:

- adding additional business development and support staff;
- attending and sponsoring key industry conferences; and
- adding systems infrastructure to support client service and portfolio administration.

The cost of these efforts was significant, but the Company believes the cost will be proportional to the increase in revenue during 2011 and future years. There can be no assurance that the Company's marketing efforts will prove successful; however, given the strong investment results of the Funds and separately managed accounts, the Company believes the additional resources devoted to marketing are warranted.

Also recognizing that the Company's primary responsibility is to clients, the Company will continue to invest in its investment team and close investment strategies to new investors when appropriate. Over the last three years, the Company substantially increased its equity investment team by growing the team from 20 at the end of 2007 to 30 at the end of 2010. Most of the additional investment team staff has been on the research team, which now totals 19.

The Company believes that one of the most important characteristics exhibited by the best investment firms is excellent investment returns for their clients over a long period of time. The Company is pleased that, during its history as an investment advisory firm, it has delivered what it believes are excellent investment returns for its clients. However, the Company is mindful that if it fails to do so in the future, its financial condition, results of operations and business growth will likely be negatively impacted. There are certain additional business risks that may prevent the Company from achieving the above growth prospects. These risks are detailed in Item 1A.

Fund Administration Activities

DHCM and Beacon Hill provide fund administration services to Diamond Hill Funds and other third party mutual fund companies. Fund administration services are broadly defined as portfolio and regulatory compliance, treasury and financial oversight, underwriting, and general oversight of other back-office services providers such as the custodian, fund accountant, and transfer agent. During the past four years, there has been continuing consolidation in the mutual fund servicing industry, whereby large financial services firms have purchased independent mutual fund service providers. Some of these larger financial services firms have made the decision not to offer statutory underwriting services to mutual funds, due to regulatory and other business conflicts. This consolidation, along with a growing desire for transparent and independent oversight of mutual fund financial reporting and compliance program activities, has provided opportunities in the marketplace for the Company to grow its fund administration services. During 2008, Beacon Hill completed the build out of its infrastructure and began operations. During 2009 and 2010, Beacon Hill continued to focus on growing its client base.

Competition

Competition in the area of investment management services and mutual funds is intense, and the Company's competitors include investment management firms, broker-dealers, banks and insurance companies, some of whom offer various investment alternatives. Many competitors are better known than the Company, offer a broader range of investment products and have more offices, employees and business development representatives. The Company competes primarily on the basis of investment philosophy, performance and client service.

Table of Contents

Corporate Investment Portfolio

From time to time the Company will hold investment positions in Diamond Hill Funds and its private investment funds.

Regulation

DHCM is registered with the SEC under the Investment Advisers Act of 1940 (the Advisers Act) and operates in a highly regulated environment. The Advisers Act imposes numerous obligations on registered investment advisers, including fiduciary duties, recordkeeping requirements, operational requirements and disclosure obligations. All Diamond Hill Funds are registered with the SEC under the Investment Company Act of 1940 and are required to make notice filings with all states where it is offered for sale. Virtually all aspects of the Company's investment management business are subject to various federal and state laws and regulations. BHIL is registered with the SEC as a broker/dealer and is a member of the Financial Industry Regulatory Authority, Inc. (FINRA).

Generally, these laws and regulations are intended to benefit shareholders of the funds and separately managed account clients and grant supervisory agencies and bodies broad administrative powers, including the power to limit or restrict the Company from carrying on its investment management and mutual fund underwriting business in the event that it fails to comply with such laws and regulations. In such event, possible sanctions which may be imposed include the suspension of individual employees, limitations on engaging in various activities for specified periods of time, the revocation of broker-dealer or investment adviser registration, and other censures or fines. The Company continuously monitors legislative, tax, regulatory, accounting and compliance developments that could impact its business.

Contractual Relationships with the Diamond Hill Funds

The Company is very dependent on its contractual relationships with the Funds. In the event the Company's advisory or administration agreements with the Funds are terminated, not renewed, or amended to reduce fees, the Company would be materially and adversely affected. Generally, these agreements are terminable by either party upon 60 days written notice without penalty. The agreements are subject to annual approval by either (i) the board of trustees of the Funds or (ii) a vote of the majority of the outstanding voting securities of each Fund. The agreements automatically terminate in the event of their assignment by either the Company or the Fund. The Company generated approximately 66%, 69% and 72% of its 2010, 2009 and 2008 revenues, respectively, from its advisory and administrative contracts with the Funds, including 31% from the advisory contract with the Diamond Hill Long-Short Fund during 2010. The loss of the Long-Short Fund contract would have a material adverse effect on the Company. The Company considers its relationship with the Funds and their board of trustees to be good, and it has no reason to believe that these advisory or administration contracts will not be renewed in the future; however, there is no assurance that the Funds will choose to continue their relationships with the Company.

Employees

As of December 31, 2010, the Company and its subsidiaries employed 77 full-time and part-time employees. As of December 31, 2009, the comparable number was 67. The Company believes that its relationship with its employees is good and does not anticipate any material change in the number of employees.

SEC Filings

The Company maintains an Internet website at www.diamond-hill.com. Annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports, filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, are made available free of charge, on or through the Company's website, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. The contents of the Company's website are not incorporated into, or otherwise made a part of, this Annual Report on Form 10-K.

Table of Contents

ITEM 1A. Risk Factors

An investment in the Company's common shares involves various risks, including those mentioned below and those that are discussed from time-to-time in the Company's other periodic filings with the SEC. Investors should carefully consider these risks, along with the other information contained in this report, before making an investment decision regarding the Company's common shares. There may be additional risks of which the Company is currently unaware, or which it currently considers immaterial. The occurrence of any of these risks could have a material adverse effect on the Company's financial condition and results of operations and value of its common shares.

Poor investment performance of our products could affect our sales or reduce the amount of assets under management, potentially negatively impacting revenue and net income.

If the Company fails to deliver excellent investment performance for its clients, both in the short and long term, it will likely experience diminished investor interest and potentially a diminished level of AUM.

The Company's AUM, which impacts revenue, is subject to significant fluctuations.

Substantially all revenue for the Company is calculated as a percentage of AUM or is based on the general performance of the equity securities market. A decline in securities prices (such as that experienced during the last half of 2008 and first quarter of 2009) or in the sale of investment products, or an increase in fund redemptions, generally would reduce fee income. Financial market declines would generally negatively impact the level of the Company's AUM and consequently its revenue and net income. A recession or other economic or political events could also adversely impact the Company's revenue, if such events led to a decreased demand for products, a higher redemption rate, or a decline in securities prices.

The Company's success depends on its key personnel, and its financial performance could be negatively affected by the loss of their services.

The Company's success depends on highly skilled personnel, including portfolio managers, research analysts, and management, many of whom have specialized expertise and extensive experience in the investment management industry. Financial services professionals are in high demand, and the Company faces significant competition for qualified employees. With the exception of the Chief Executive Officer, key employees do not have employment contracts and generally can terminate their employment at any time. The Company cannot assure that it will be able to retain or replace key personnel. In order to retain or replace its key personnel, the Company may be required to increase compensation, which would decrease net income. The loss of key personnel could damage the Company's reputation and make it more difficult to retain and attract new employees and clients. A loss of client assets resulting from the departure of key personnel would decrease the Company's revenues and net income, possibly materially.

The Company is subject to substantial competition in all aspects of its business.

The Company's investment products compete against a number of investment products and services from:
asset management firms;

mutual fund companies;

commercial banks and thrift institutions;

insurance companies;

hedge funds; and

brokerage and investment banking firms.

Many of these financial institutions have substantially greater resources than the Company and may offer a broader range of products or operate in more markets. Some of these institutions operate in a different regulatory environment, which may give them certain competitive advantages in the investment products and portfolio structures that they offer. The Company competes with other providers of investment advisory services primarily based upon its investment philosophy, performance and client service. Some institutions have proprietary products and distribution channels that make it more difficult for the Company to compete with them. If current or potential customers decide to

use one of the Company's competitors, the Company could face a significant decline in market share, AUM, revenues, and net income. If the Company is required to lower its fees in order to remain competitive, its net income could be significantly reduced because some of its expenses are fixed, especially over shorter periods of time, and other expenses may not decrease in proportion to the decrease in revenues.

Table of Contents

A significant portion of the Company's revenues are based on contracts with the Diamond Hill Funds that are subject to termination without cause and on short notice.

The Company is very dependent on its contractual relationships with the Funds. In the event the Company's advisory or administration agreements with the Funds are terminated, not renewed, or amended to reduce fees, the Company would be materially and adversely affected. Generally, these agreements are terminable by either party upon 60 days written notice without penalty. The agreements are subject to annual approval by either (i) the board of trustees of the Funds or (ii) a vote of the majority of the outstanding voting securities of each Fund. The agreements automatically terminate in the event of their assignment by either the Company or the Fund. The Company generated approximately 66%, 69% and 72% of its 2010, 2009 and 2008 revenues, respectively, from its advisory and administrative contracts with the Funds, including 31% from the advisory contract with the Diamond Hill Long-Short Fund during 2010. The loss of the Long-Short Fund contract would have a material adverse effect on the Company. The Company considers its relationship with the Funds and their board of trustees to be good, and it has no reason to believe that these advisory or administration contracts will not be renewed in the future; however, there is no assurance that the Funds will choose to continue their relationships with the Company.

The Company's business is subject to substantial governmental regulation.

The Company's business is subject to a variety of federal securities laws including the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Securities Exchange Act of 1934, the Sarbanes-Oxley Act of 2002, and the U.S. Patriot Act of 2001. In addition, the Company is subject to significant regulation and oversight by the SEC and FINRA. Changes in legal, regulatory, accounting, tax and compliance requirements could have a significant effect on the Company's operations and results, including but not limited to increased expenses and reduced investor interest in certain funds and other investment products offered by the Company. The Company continually monitors legislative, tax, regulatory, accounting, and compliance developments that could impact its business.

The Company will continue to seek to understand, evaluate and when possible, manage and control these and other business risks.

ITEM 1B. Unresolved Staff Comments

None.

ITEM 2. Properties

The Company leases approximately 21,200 square feet of office space at two locations.

The Company does not own any real estate or interests in real estate.

ITEM 3. Legal Proceedings

From time to time, the Company is party to ordinary routine litigation that is incidental to its business. The Company believes these claims will not have a material adverse effect on its financial condition, liquidity or results of operations.

ITEM 4. (Removed and Reserved)

Table of Contents**PART II****ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The following performance graph compares the total shareholder return of an investment in Diamond Hill's Common Stock to that of the Russell Microcap® Index, and to a peer group index of publicly traded asset management firms for the five-year period ending on December 31, 2010. The graph assumes that the value of the investment in Diamond Hill's Common Stock and each index was \$100 on December 31, 2005. Total return includes reinvestment of all dividends. The Russell Microcap® Index makes up less than 3% of the U.S. equity market and is a market-value-weighted index of the smallest 1,000 securities in the small-cap Russell 2000® Index plus the next 1,000 smallest securities. Peer Group returns are weighted by the market capitalization of each firm at the beginning of the measurement period. The historical information set forth below is not necessarily indicative of future performance. Diamond Hill does not make or endorse any predictions as to future stock performance.

	12/31/2005	12/31/2006	12/31/2007	12/31/2008	12/31/2009	12/31/2010
Diamond Hill Investment Group, Inc.	100	268	234	238	274	364
Russell Microcap® Index	100	117	107	65	82	106
Peer Group*	100	112	119	44	66	77

* The following companies are included in the Peer Group: Westwood Holdings Group, Inc.; Epoch Holding Corp.; Eaton Vance Corp.; Waddell & Reed Financial, Inc.; Federated Investors, Inc.; GAMCO Investors, Inc.; Affiliated Managers Group, Inc.; Legg Mason, Inc.; U.S. Global Investors, Inc.; Alliance Bernstein Holding L.P.; Janus Capital Group, Inc.; SEI Investments, Co.; Cohen & Steers, Inc.; and Calamos Asset Management, Inc.

Table of Contents

The Company's common shares trade on the NASDAQ Global Select Market under the symbol DHIL. The following table sets forth the high and low sales prices during each quarter of 2010 and 2009:

Quarter ended:	2010			2009		
	High Price	Low Price	Dividend Per Share	High Price	Low Price	Dividend Per Share
March 31	\$ 74.84	\$ 54.58	\$	\$ 67.74	\$ 28.51	\$
June 30	\$ 82.49	\$ 55.88	\$	\$ 45.50	\$ 36.26	\$
September 30	\$ 74.95	\$ 50.52	\$	\$ 62.00	\$ 38.48	\$
December 31	\$ 86.15	\$ 68.86	\$ 13.00	\$ 71.95	\$ 52.33	\$ 10.00

Due to the relatively low volume of traded shares, quoted prices cannot be considered indicative of any viable market for such shares. During the years ended December 31, 2010 and 2009, approximately 2,025,600 and 2,957,900, respectively, of the Company's common shares were traded. The dividends indicated above were special dividends. The Company has not paid regular quarterly dividends in the past two years, and has no present intention of paying regular dividends in the future. The approximate number of registered holders of record of the Company's common shares at December 31, 2010 was 247.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The Company did not purchase any shares of its common stock during the year ended December 31, 2010. The following table sets forth information regarding the Company's repurchase program of its common stock during the fourth quarter of fiscal year 2010:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as part of a Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (1)
October 1, 2010 through October 31, 2010			16,105	333,895
November 1, 2010 through November 30, 2010			16,105	333,895
December 1, 2010 through December 31, 2010			16,105	333,895

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

Table of Contents**ITEM 6. Selected Financial Data**

The following selected financial data should be read in conjunction with the Company's Consolidated Financial Statements and related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in this Annual Report on Form 10-K.

	For the Years Ended December 31,				
	2010	2009	2008	2007	2006
Income Statement Data (in thousands):					
Total revenues	\$ 56,704	\$ 43,562	\$ 47,019	\$ 41,308	\$ 31,905
Compensation and related costs	30,991	24,114	26,120	20,007	18,147
Other expenses	7,240	7,336	7,170	7,223	3,989
Total expenses	38,231	31,450	33,290	27,230	22,136
Net operating income	18,473	12,112	13,729	14,078	9,769
Net income	12,402	11,374	3,276	9,932	8,065
Operating profit margin	32.6%	27.8%	29.2%	34.1%	30.6%
Per Share Information:					
Basic earnings	\$ 4.48	\$ 4.40	\$ 1.36	\$ 4.61	\$ 4.51
Diluted earnings	4.48	4.40	1.36	4.39	3.63
Cash dividend declared	13.00	10.00	10.00		
Weighted Average Shares Outstanding					
Basic	2,766,741	2,582,998	2,400,142	2,155,829	1,787,390
Diluted	2,767,895	2,587,751	2,408,476	2,264,234	2,219,580
	At December 31,				
	2010	2009	2008	2007	2006
Balance Sheet Data (in thousands):					
Total assets	\$ 28,566	\$ 40,505	\$ 44,540	\$ 53,284	\$ 37,236
Long-term debt					
Shareholders equity	7,498	22,981	30,246	39,308	20,483
Assets Under Management (in millions)	\$ 8,623	\$ 6,283	\$ 4,510	\$ 4,403	\$ 3,708
Net Client Flows (in millions)	1,698	579	1,977	602	1,938

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

In this section, the Company discusses and analyzes the consolidated results of operations for the past three fiscal years and other factors that may affect future financial performance. This discussion should be read in conjunction with the Company's Consolidated Financial Statements, Notes to the Consolidated Financial Statements, and Selected Financial Data contained in this Form 10-K.

The Company's revenue is derived primarily from investment advisory and administration fees. Investment advisory and administration fees paid to the Company are generally based on the value of the investment portfolios managed by the Company and fluctuate with changes in the total value of the AUM. Such fees are recognized in the period that the Company manages these assets. Performance incentive fees are generally 20% of the amount of client annual investment performance in excess of a specified hurdle. Because performance incentive fees are based primarily on the performance of client accounts, they can be volatile from period to period. The Company's primary expense is employee compensation and benefits.

Table of Contents

Revenues are highly dependent on both the value and composition of AUM. The following is a summary of the Company's AUM for each of the years ended December 31, 2010, 2009, and 2008:

(in millions)	Assets Under Management by Product		
	As of December 31,		
	2010	2009	2008
Mutual funds	\$ 4,198	\$ 3,494	\$ 3,010
Sub-advised funds	930	146	104
Separate accounts	3,284	2,423	1,175
Private investment funds	211	220	221
Total AUM	\$ 8,623	\$ 6,283	\$ 4,510

(in millions)	Change in Assets Under Management		
	For the Year Ended December 31,		
	2010	2009	2008
AUM at beginning of the year	\$ 6,283	\$ 4,510	\$ 4,403
Net cash inflows (outflows)			
mutual funds	467	(109)	1,328
sub-advised mutual funds	714	6	54
separate accounts	532	734	757
private investment funds	(15)	(52)	(162)
	1,698	579	1,977
Net market appreciation (depreciation) and income	642	1,194	(1,870)
Increase during the year	2,340	1,773	107
AUM at end of the year	\$ 8,623	\$ 6,283	\$ 4,510

Consolidated Results of Operations

The following is a discussion of the consolidated results of operations of the Company and a detailed discussion of the Company's revenues and expenses.

(in thousands, except per share data)	2010	2009	% Change	2009	2008	% Change
Net operating income	\$ 18,473	\$ 12,112	53%	\$ 12,112	\$ 13,729	-12%
Net operating income after tax ^(a)	\$ 11,643	\$ 7,867	48%	\$ 7,867	\$ 8,143	-3%
Net income	\$ 12,402	\$ 11,374	9%	\$ 11,374	\$ 3,276	247%
Net operating income after tax per share^(a)						
Basic	\$ 4.21	\$ 3.05	38%	\$ 3.05	\$ 3.39	-10%
Diluted	\$ 4.21	\$ 3.04	38%	\$ 3.04	\$ 3.38	-10%
Net income per share						
Basic	\$ 4.48	\$ 4.40	2%	\$ 4.40	\$ 1.36	224%
Diluted	\$ 4.48	\$ 4.40	2%	\$ 4.40	\$ 1.36	224%
Operating profit margin	32.6%	27.8%	NM	27.8%	29.2%	NM

(a) - Net operating income after tax is a non-GAAP performance measure. See Use of Supplemental Data as Non-GAAP Performance Measure on page 18 of this report.

Year Ended December 31, 2010 compared with Year Ended December 31, 2009

The Company posted net income of \$12.4 million (\$4.48 per diluted share) for the year ended December 31, 2010, compared with net income of \$11.4 million (\$4.40 per diluted share) for the year ended December 31, 2009. Net income increased \$1.0 million due to a \$6.4 million increase in operating income driven by a 37% increase in AUM from 2009 to 2010, offset by a \$4.2 million decrease in the investment return of the Company's corporate investment portfolio from 2009 to 2010. Operating profit margin increased to 32.6% for 2010 from 27.8% for 2009. The Company expects that its operating margin will fluctuate from year to year based on various factors including revenues; investment results; employee performance; staffing levels; development of investment strategies, products, or channels; and industry comparisons.

Table of Contents**Year Ended December 31, 2009 compared with Year Ended December 31, 2008**

The Company posted net income of \$11.4 million (\$4.40 per diluted share) for the year ended December 31, 2009, compared with net income of \$3.3 million (\$1.36 per diluted share) for the year ended December 31, 2008. Net income increased due to a \$5.4 million positive return on the Company's corporate investment portfolio in 2009 compared to an \$8.2 million negative return in 2008. This improvement was partially offset by a decrease in operating income of \$1.6 million, due to a shift in the composition of AUM from higher fee products to lower fee products, combined with the operating loss from Beacon Hill.

Revenue

(in thousands)	2010	2009	%Change	2009	2008	% Change
Investment advisory	\$ 49,249	\$ 37,472	31%	\$ 37,472	\$ 40,865	-8%
Mutual fund administration, net	\$ 7,455	6,090	22%	6,090	6,154	-1%
Total	56,704	43,562	30%	43,562	47,019	-7%

Revenue for the Year Ended December 31, 2010 compared with Year Ended December 31, 2009

As a percent of total 2010 revenues, investment advisory fees accounted for 87% and mutual fund administration fees made up the remaining 13%. This compared to 86% and 14%, respectively, for 2009.

Investment Advisory Fees. Investment advisory fees increased by \$11.8 million, or 31%, due to a 43% increase in average AUM from 2009 to 2010. Investment advisory fees are calculated as a percentage of average net AUM at various levels depending on the investment product. The Company's average advisory fee rate for 2010 was 0.70% compared to 0.76% in 2009. The decrease in the average advisory fee rate is due to a continued change in the overall composition of AUM first seen during 2008, where long-short strategies, which pay a higher advisory fee rate, made up 26% of total AUM in 2010 compared to 36% of total AUM in 2009 while long only strategies, which pay a lower advisory fee rate, made up 54% of total AUM in 2010 compared to 42% of total AUM in 2009. Despite the 0.06% decrease in the average advisory fee rate during 2010 compared to 2009, the fee rate was being charged on a greater asset base as the average AUM increased 43% during the year compared to 2009 resulting in an increase in the overall fees earned during 2010. The Company anticipates the average advisory fee rate to continue to decrease throughout 2011 based upon the continued change in asset composition due to asset growth in lower fee strategies.

Mutual Fund Administration Fees. Mutual fund administration fees increased \$1.4 million, or 22%, during 2010. Fund administration revenue on the Company's sponsored Diamond Hill Funds increased \$1.1 million from 2009 to 2010, due in part to a 28% increase in average mutual fund AUM, which was partially offset by a reduction in the average administration net fee rate from 0.18% in 2009 to 0.17% in 2010. Further contributing to the increase in revenue was a \$199 thousand increase in Beacon Hill's revenue from 2009 to 2010.

Revenue for the Year Ended December 31, 2009 compared with Year Ended December 31, 2008

As a percent of total 2009 revenues, investment advisory fees accounted for 86% and mutual fund administration fees made up the remaining 14%. This compared to 87% and 13%, respectively, for 2008.

Investment Advisory Fees. The overall decrease of \$3.4 million in investment advisory fees was primarily due to a shift in AUM composition from long-short strategies to long only strategies, resulting in a lower average advisory fee. Investment advisory fees are generally calculated as a percentage of average net AUM at various levels, depending on the investment product. The Company's average advisory fee rate for the year ended December 31, 2009 was 0.76% compared to 0.81% for the year ended December 31, 2008. During 2009, the Long-Short Fund, which has a 0.90% advisory fee, experienced cash outflows resulting in a decrease in assets of \$366 million. These outflows contributed to the decrease in the average advisory fee rate for 2009 compared to 2008.

Table of Contents

Mutual Fund Administration Fees. Mutual fund administration fees were relatively flat year over year. Fund administration revenue on the Company's sponsored Diamond Hill Funds decreased \$825 thousand from 2008 to 2009, due in part to a 12% decrease in average AUM. This decrease in revenue was offset by a \$761 thousand increase in Beacon Hill's revenue from 2008 to 2009.

Expenses

(in thousands)	2010	2009	% Change	2009	2008	% Change
Compensation and related costs	\$ 30,991	\$ 24,114	29%	\$ 24,114	\$ 26,120	-8%
General and administrative	3,409	3,133	9%	3,133	2,643	19%
Sales and marketing	854	751	14%	751	796	-6%
Third party distribution	1,036	1,112	-7%	1,112	1,452	-23%
Mutual fund administration	1,941	2,340	-17%	2,340	2,279	3%
Total	38,231	31,450	22%	31,450	33,290	-6%

Expenses for the Year Ended December 31, 2010 compared with Year Ended December 31, 2009

Compensation and Related Costs. Employee compensation and benefits increased by \$6.9 million, or 29%, primarily due to an increase of \$3.8 million in incentive compensation during 2010 consistent with an increase in AUM and the associated increase in operating income. Further contributors to the overall increase in compensation expense were restricted stock expense, which increased by \$718 thousand due to an overall increase in the total amount of long-term equity awards outstanding in 2010 compared to 2009, and base salaries and related benefits, which increased \$1.3 million due to a 15% increase in employee headcount from 2009 to 2010.

General and Administrative. General and administrative expenses increased by \$276 thousand, or 9%, from 2009 to 2010. This increase was primarily due to additional research expenses to support the Company's investment team, the full year impact of the expansion of the Company's office space and the implementation of a new trading system, which were partially offset by a decrease in legal costs and a phase-out of the Ohio franchise tax expense.

Sales and Marketing. Sales and marketing expenses increased by \$103 thousand, or 14%, from 2009 to 2010. This increase was primarily due to an increased presence at industry conferences and an increase in travel and other expenses related to business development and retention efforts during the year.

Third Party Distribution. Third party distribution expense represents payments made to third party intermediaries directly related to sales made by those parties of the Company's investment products. This expense directly correlates with level of sales and AUM in these investment products. The period over period increase or decrease directly corresponds to the increase or decrease in investment advisory fees earned by the Company.

Mutual Fund Administration. Mutual fund administration expenses decreased by \$399 thousand, or 17%, from 2009 to 2010. The majority of mutual fund administration fees are variable based upon the amount of mutual fund AUM. Despite an overall increase in average mutual fund AUM by 28% from 2009 to 2010, the decrease in mutual fund administration expense was primarily due to a third party service provider fee reduction related to bringing certain administration activities in-house.

Table of Contents**Expenses for the Year Ended December 31, 2009 compared with Year Ended December 31, 2008**

Compensation and Related Costs. Employee compensation and benefits decreased by \$2 million, or 8%, in 2009, primarily due to a decrease of \$2.6 million in restricted stock expense due to an overall decrease in the total amount of long-term equity awards outstanding in 2009 compared to 2008, partially offset by an increase in base salaries and related benefits of \$1.3 million due to a 16% increase in employee headcount. Incentive compensation decreased \$700 thousand in 2009 compared to 2008.

General and Administrative. General and administrative expenses increased by \$490 thousand, or 19%. This increase was primarily due to additional research expenses to support the Company's investment team, expansion of the Company's office space, and additional legal costs incurred during 2009 compared to 2008.

Sales and Marketing. Sales and marketing expenses decreased by \$45 thousand, or 6%, during 2009. This decrease was primarily due to one-time marketing projects that were completed during 2008, partially offset by an increase in expense related to marketing materials and additional travel expense incurred related to new business attained during the year.

Third Party Distribution. Third party distribution expense represents payments made to third party intermediaries directly related to sales made by those parties of the Company's investment products. This expense directly correlates with level of sales and AUM in these investment products. The period over period increase or decrease directly corresponds to the increase or decrease in investment advisory fees earned by the Company.

Mutual Fund Administration. Mutual fund administration expenses increased by \$61 thousand, or 3%, during 2009, primarily due to a fee increase of \$150 thousand from the sub-administrator, partially offset by decreases in prospectus fulfillment and other printing.

Beacon Hill Fund Services

Beacon Hill is currently staffed with 13 full-time equivalent employees, up from 12 at December 31, 2009, and provides compliance, treasurer, and other fund administration services to mutual fund clients and their investment advisors. In addition, through its registered broker/dealer, Beacon Hill also serves as the underwriter for a number of mutual funds. The following is a summary of Beacon Hill's performance for the year ended December 31, 2010 compared to 2009, excluding 12b-1 / service fees and commission revenue and expenses, which net to zero:

	For the Year Ended December 31,		
	2010	2009	2008
Revenue ¹	\$ 1,588,243	\$ 1,023,662	\$ 116,516
Expenses	2,407,417	1,999,922	1,513,731
Net loss	\$ (819,174)	\$ (976,260)	\$ (1,397,215)

¹ Beacon Hill's 2010, 2009, and 2008 revenue includes \$511,625, \$146,067, and \$0, respectively, of inter-company revenue earned from services provided to DHCM. This amount has been eliminated from the Consolidated Statements of Income.

Liquidity and Capital Resources

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

Table of Contents

As of December 31, 2010, the Company had working capital of approximately \$4.9 million compared to \$20.5 million at December 31, 2009. Working capital includes cash, securities owned and accounts receivable, net of all liabilities. On September 17, 2010, the Company's board of directors declared a \$13 per share dividend payable on December 15, 2010 to shareholders of record on December 1, 2010. The payment of the special cash dividend contributed to the reduction in the Company's working capital balance. The Company has no debt, and believes its available working capital is sufficient to cover current expenses. The Company does not expect any material capital expenditures during 2011.

The Company has paid out special dividends over the past three years consisting of a \$13 per share dividend in 2010, a \$10 per share dividend in 2009, and a \$10 per share dividend in 2008. These special dividends in total reduced shareholders' equity by \$87 million over the past three years. The 2010 special dividend reduced shareholders' equity by \$36.3 million and was recorded as a reduction of retained earnings, which generated an accumulated deficit of \$19.8 million as of December 31, 2010. The Company's accumulated deficit is not expected to impact its future ability to operate given its continuing profitability and strong cash and financial position. The 2009 special dividend reduced shareholders' equity by \$26.2 million and was recorded through retained earnings. A portion of the 2009 and 2010 dividend was a return of capital for tax purposes and the Company elected to record each dividend as a reduction of retained earnings. The 2008 special dividend reduced shareholders' equity by \$24.4 million and was recorded through common stock as 100% of this dividend represented a return of capital to shareholders.

Operating activities during 2010 provided cash flows of \$25.1 million, up \$8.1 million from 2009, including an increase in net income of \$1.0 million, an increase in the change in non-cash stock based compensation expense of \$718 thousand, an increase in the change in accounts receivable of \$6.3 million, an increase in the change in investment gain/loss of \$4.2 million, and an increase in the change in accrued liabilities of \$1.1 million, offset by a decrease in the change in deferred taxes of \$1.8 million, and a decrease in the change in other assets and liabilities of \$3.4 million. Net cash provided in investing activities totaled \$4.6 million, compared to net cash provided in investing activities of \$4.2 million in 2009. Capital spending for property and equipment decreased to \$63 thousand in 2010, a decrease of \$542 thousand from 2009, and proceeds from the sales of investments decreased to \$6.1 million in 2010, a decrease of \$7.9 million from 2009. Net cash used by financing activities was \$35.5 million in 2010, compared to net cash used by financing activities of \$25.5 million in 2009. Cash used by financing activities in 2010 consists of \$36.3 million special dividend payment offset by proceeds from common stock issuances.

Operating activities during 2009 provided cash flows of \$16.9 million, down \$409 thousand from 2008, including a decrease in the change in non-cash stock based compensation expense of \$2.7 million, a decrease in the change in accounts receivable of \$5.2 million, and a decrease in the change in investment gain/loss of \$7.4 million, offset by an increase in net income of \$8.1 million, an increase in the change in deferred taxes of \$4.0 million, and an increase in the change in other assets and liabilities of \$3.6 million. Net cash provided in investing activities totaled \$4.2 million, compared to net cash provided in investing activities of \$13 million in 2008. Capital spending for property and equipment increased to \$605 thousand in 2009, an increase of \$242 thousand from 2008, and proceeds from the sales of investments decreased to \$13.9 million in 2009, a decrease of \$9.6 million from 2008. Net cash used by financing activities was \$25.5 million in 2009, compared to net cash used by financing activities of \$26.6 million in 2008. The decrease of \$1.1 million in cash used by financing activities included a decrease in taxes withheld on employee stock transactions of \$2.6 million, partially offset by an increase in the dividend payment of \$1.7 million in 2009.

Table of Contents**Selected Quarterly Information**

Unaudited quarterly results of operations for the years ended December 31, 2010 and 2009 is summarized below:

(in thousands, except per share data)	At or For the Quarter Ended							
	2010				2009			
	12/31	09/30	06/30	03/31	12/31	09/30	06/30	03/31
Assets Under Management (in millions)	\$ 8,623	\$ 7,080	\$ 6,482	\$ 6,876	\$ 6,283	\$ 5,489	\$ 4,733	\$ 3,909
Total revenue	15,516	14,043	13,754	13,391	13,715	11,372	9,592	8,883
Total operating expenses	9,272	9,844	9,652	9,462	9,110	8,523	7,061	6,756
Operating income	6,244	4,199	4,102	3,929	4,605	2,849	2,531	2,127
Investment Return	974	1,170	(1,184)	245	881	2,064	4,032	(1,579)
Net income	\$ 4,464	\$ 3,438	\$ 1,830	\$ 2,670	\$ 3,504	\$ 3,204	\$ 4,315	\$ 351
Diluted EPS	\$ 1.60	\$ 1.24	\$ 0.66	\$ 0.98	\$ 1.34	\$ 1.23	\$ 1.66	\$ 0.14
Diluted shares outstanding	2,794	2,779	2,774	2,721	2,621	2,612	2,603	2,516

Contractual Obligations

The following table presents a summary of the Company's future obligations under the terms of an operating lease and other contractual purchase obligations at December 31, 2010. Other purchase obligations include contractual amounts that will be due for the purchase of services to be used in the Company's operations such as mutual fund sub-administration and portfolio accounting software. These obligations may be cancelable at earlier times than those indicated and, under certain conditions, may involve termination fees. Because these obligations are of a normal recurring nature, the Company expects that it will fund them from future cash flows from operations. The information presented does not include operating expenses or capital expenditures that will be committed in the normal course of operations in 2011 and future years:

	Total	2011	Payments Due by Period		
			2012-2013	2014-2015	Later
Operating lease obligations	\$ 1,973,000	\$ 340,000	\$ 704,000	\$ 719,000	\$ 210,000
Purchase obligations	2,989,000	2,413,000	434,000	142,000	
Total	\$ 4,962,000	\$ 2,753,000	\$ 1,138,000	\$ 861,000	\$ 210,000

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

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

Table of Contents

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

(in thousands, except per share data)	Year Ended December 31,		
	2010	2009	2008
Net operating income, GAAP basis	\$ 18,473	\$ 12,112	\$ 13,729
Non-GAAP Adjustments:			
Tax Provision excluding impact of Investment Return	6,830	4,245	5,586
Net operating income after tax, non-GAAP basis	11,643	7,867	8,143
Net operating income after tax per basic share, non-GAAP basis	\$ 4.21	\$ 3.05	\$ 3.39
Net operating income after tax per diluted share, non-GAAP basis	\$ 4.21	\$ 3.04	\$ 3.38
Basic weighted average shares outstanding, GAAP basis	2,767	2,583	2,400
Diluted weighted average shares outstanding, GAAP basis	2,768	2,588	2,408

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

Off-Balance Sheet Arrangements

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

Critical Accounting Policies and Estimates

Provisions for Income Taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in the Company's financial statements or tax returns.

Revenue Recognition on Incentive-Based Advisory Contracts. The Company has certain investment advisory contracts in which a portion of the fees are based on investment performance achieved in the respective client portfolio in excess of a specified hurdle rate. For management fees based on a formula, there are two methods by which incentive revenue may be recorded. Under Method 1, incentive fees are recorded at the end of the contract year. Under Method 2, incentive fees are recorded periodically and calculated as the amount that would be due under the formula at any point in time as if the contract was terminated at that date. Management has chosen the more conservative Method 1, in which performance fees are recorded at the end of the contract period provided for by the contract terms.

Revenue Recognition when Acting as an Agent vs. Principal. The Funds have selected and contractually engaged certain vendors to fulfill various services to benefit the Funds' shareholders or to satisfy regulatory requirements of the Funds. These services include, among others, required fund shareholder mailings, registration fees, legal and audit fees. DHCM, in fulfilling a portion of its role under the administration agreement with the Funds, acts as agent to pay these obligations of the Funds. Each vendor is independently responsible for fulfillment of the services it has been engaged to provide and negotiates fees and terms with the management and board of trustees of the Funds. The fee that the Funds pay to DHCM is reviewed annually by the Funds' board of trustees and specifically takes into account the contractual expenses that DHCM pays on behalf of the Funds. As a result, DHCM is not involved in the delivery

or pricing of these services and bears no risk related to these services. Revenue has been recorded net of these Fund expenses, as it is the appropriate accounting treatment for this agency relationship.

Table of Contents

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

ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk

The Company's revenues and net income are based primarily on the value of AUM. Accordingly, declines in financial market values directly and negatively impact the Company's investment advisory revenues and net income.

The Company invests in Diamond Hill Funds and its private investment funds, which are market risk sensitive financial instruments. These investments have inherent market risk in the form of equity price risk; that is, the potential future loss of value that would result from a decline in their fair value. The bond fund is also subject to market risk which may arise from changes in equity prices, credit ratings and interest rates. Market prices fluctuate and the amount realized upon subsequent sale may differ significantly from the reported market value.

The table below summarizes the Company's market risks as of December 31, 2010, and shows the effects of a hypothetical 10% increase and decrease in equity and bond investments.

	Fair Value as of December 31, 2010	Fair Value Assuming a Hypothetical 10% Increase	Fair Value Assuming a Hypothetical 10% Decrease
Equity investments	\$ 11,328,494	\$ 12,461,343	\$ 10,195,645
Bond investments	198,566	218,423	178,709
Total	\$ 11,527,060	\$ 12,679,766	\$ 10,374,354

Table of Contents

ITEM 8. Financial Statements and Supplementary Data
Report of Independent Registered Public Accounting Firm

The Shareholders and Board of Directors of
Diamond Hill Investment Group, Inc.:

We have audited the accompanying consolidated balance sheet of Diamond Hill Investment Group, Inc. and its subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of income, shareholders equity, and cash flows for each of the years in the three-year period ended December 31, 2010. We also have audited the Company's internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying financial statements. Our responsibility is to express an opinion on these financial statements and an opinion on the company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Diamond Hill Investment Group, Inc. and its subsidiaries as of December 31, 2010 and 2009, and the consolidated results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2010 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, Diamond Hill Investment Group, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/ Plante & Moran, PLLC

Columbus, Ohio

February 22, 2011

Table of Contents**Diamond Hill Investment Group, Inc.
Consolidated Balance Sheets**

	December 31,	
	2010	2009
ASSETS		
Cash and cash equivalents	\$ 5,775,526	\$ 11,513,194
Investment portfolio	11,527,060	16,429,967
Accounts receivable	8,695,103	10,144,004
Prepaid expenses	787,033	724,825
Fixed assets, net of depreciation, and other assets	907,670	1,171,670
Deferred taxes	873,474	520,965
Total assets	\$ 28,565,866	\$ 40,504,625
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities		
Accounts payable and accrued expenses	\$ 4,101,079	\$ 4,465,011
Accrued incentive compensation	16,111,250	12,300,650
Income tax payable	855,285	758,257
Total liabilities	21,067,614	17,523,918
Commitments and contingencies		
Shareholders Equity		
Common stock, no par value		
7,000,000 shares authorized;		
2,795,683 issued and outstanding at December 31, 2010;		
2,677,577 issued and outstanding at December 31, 2009	34,423,011	26,922,484
Preferred stock, undesignated, 1,000,000 shares authorized and unissued		
Deferred compensation	(7,137,729)	(8,070,697)
Retained earnings/(Accumulated deficit)	(19,787,030)	4,128,920
Total shareholders equity	7,498,252	22,980,707
Total liabilities and shareholders equity	\$ 28,565,866	\$ 40,504,625
Book value per share	\$ 2.68	\$ 8.58

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

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

	Year Ended December 31,		
	2010	2009	2008
REVENUES:			
Investment advisory	\$ 49,248,586	\$ 37,472,407	\$ 40,865,296
Mutual fund administration, net	7,455,537	6,089,979	6,153,919
Total revenue	56,704,123	43,562,386	47,019,215
OPERATING EXPENSES:			
Compensation and related costs	30,990,572	24,113,631	26,120,040
General and administrative	3,408,981	3,133,359	2,643,274
Sales and marketing	853,851	751,040	796,438
Third party distribution	1,036,231	1,112,460	1,452,087
Mutual fund administration	1,941,160	2,339,544	2,278,562
Total operating expenses	38,230,795	31,450,034	33,290,401
NET OPERATING INCOME	18,473,328	12,112,352	13,728,814
Investment return	1,205,194	5,398,636	(8,205,051)
INCOME BEFORE TAXES	19,678,522	17,510,988	5,523,763
Income tax provision	(7,276,081)	(6,137,045)	(2,247,685)
NET INCOME	\$ 12,402,441	\$ 11,373,943	\$ 3,276,078
Earnings per share			
Basic	\$ 4.48	\$ 4.40	\$ 1.36
Diluted	\$ 4.48	\$ 4.40	\$ 1.36
Weighted average shares outstanding			
Basic	2,766,741	2,582,998	2,400,142
Diluted	2,767,895	2,587,751	2,408,476

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

Table of Contents**Diamond Hill Investment Group, Inc.
Consolidated Statements of Shareholders' Equity**

	Shares	Common	Treasury	Deferred	Retained Earnings (Accumulated Deficit)	Total
	Outstanding	Stock	Stock	Compensation		
Balance at January 1, 2008	2,243,653	\$ 27,719,024	\$	\$ (4,056,015)	\$ 15,644,523	\$ 39,307,532
Deferred compensation	63,450	5,184,801		(5,184,801)		
Recognition of current year deferred compensation				4,332,601		4,332,601
Issuance of stock grants	85,796	6,021,482				6,021,482
Issuance of stock related to 401k plan match	8,506	638,796				638,796
FAS 123R compensation expense		2,233				2,233
Tax benefit from equity transactions		3,997,348				3,997,348
Payment of taxes withheld related to employee stock transactions	(33,991)	(2,777,545)				(2,777,545)
Purchase of common stock related to option exercises	(4,452)	(381,843)				(381,843)
Exercise of options/warrants for common stock	95,500	1,132,204				1,132,204
Repurchase of common stock	(11,163)	(862,115)				(862,115)
Dividend Paid of \$10.00 per share		(24,440,884)				(24,440,884)
Net income					3,276,078	3,276,078
Balance at December 31, 2008	2,447,299	\$ 16,233,501	\$	\$ (4,908,215)	\$ 18,920,601	\$ 30,245,887
Deferred compensation	78,092	4,836,595		(4,836,595)		
Recognition of current year deferred compensation				1,674,113		1,674,113
Issuance of stock grants	135,313	5,032,290				5,032,290
Issuance of common stock related to 401k plan match	15,610	758,459				758,459
Tax benefit from equity transactions		134,741				134,741
Payment of taxes withheld related to employee stock transactions	(2,737)	(140,602)				(140,602)
Exercise of options/warrants for common stock	4,000	67,500				67,500
Dividend Paid of \$10.00 per share					(26,165,624)	(26,165,624)
Net income					11,373,943	11,373,943
Balance at December 31, 2009	2,677,577	\$ 26,922,484	\$	\$ (8,070,697)	\$ 4,128,920	\$ 22,980,707
Deferred compensation	20,753	1,458,898		(1,458,898)		
Recognition of current year deferred compensation				2,391,866		2,391,866

Edgar Filing: DIAMOND HILL INVESTMENT GROUP INC - Form 10-K

Issuance of stock grants	83,611	5,182,983		5,182,983
Issuance of common stock related to 401k plan match	13,631	897,842		897,842
Tax benefit from equity transactions		84,375		84,375
Payment of taxes withheld related to employee stock transactions	(1,889)	(146,071)		(146,071)
Exercise of options/warrants for common stock	2,000	22,500		22,500
Dividend Paid of \$13.00 per share			(36,318,391)	(36,318,391)
Net income			12,402,441	12,402,441
Balance at December 31, 2010	2,795,683	\$ 34,423,011	\$ (7,137,729)	\$ (19,787,030) \$ 7,498,252

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

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

	Year Ended December 31,		
	2010	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net Income	\$ 12,402,441	\$ 11,373,943	\$ 3,276,078
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on furniture and equipment	326,529	268,572	181,908
Amortization of deferred compensation	2,391,866	1,674,113	4,332,601
(Increase) decrease in accounts receivable	1,448,901	(4,804,446)	354,716
Increase (decrease) in deferred income taxes	(382,227)	1,438,658	(2,535,960)
Stock option expense			2,233
Noncash director fee expense	179,836	180,074	167,281
Investment gain/loss, net	167,495	(4,055,840)	3,298,360
Increase in accrued liabilities	8,449,814	7,323,481	8,281,581
Other changes in assets and liabilities	148,913	3,599,790	48,340
 Net cash provided by operating activities	 25,133,568	 16,998,345	 17,407,138
 CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of furniture and equipment	(62,529)	(604,928)	(362,722)
Cost of investments purchased and other portfolio activity	(1,314,588)	(9,149,453)	(10,076,234)
Proceeds from sale of investments	6,050,000	13,960,937	23,628,426
 Net cash provided by investing activities	 4,672,883	 4,206,556	 13,189,470
 CASH FLOWS FROM FINANCING ACTIVITIES:			
Payment for repurchase of common shares			(862,115)
Payment of taxes withheld on employee stock transactions	(146,071)	(140,602)	(2,777,545)
Proceeds from common stock issuance	920,343	825,959	1,489,218
Payment of dividends	(36,318,391)	(26,165,624)	(24,440,884)
 Net cash used in financing activities	 (35,544,119)	 (25,480,267)	 (26,591,326)
 CASH AND CASH EQUIVALENTS			
Net change during the period	(5,737,668)	(4,275,366)	4,005,282
At beginning of period	11,513,194	15,788,560	11,783,278
 At end of period	 \$ 5,775,526	 \$ 11,513,194	 \$ 15,788,560
 Cash paid during the period for:			
Interest	\$	\$	\$
Income taxes	7,444,300	2,625,900	3,005,000

Noncash transactions during the period for:

Common stock issued as incentive compensation	5,003,146	4,852,216	5,754,140
---	-----------	-----------	-----------

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

Table of Contents

Diamond Hill Investment Group, Inc.

Notes to Consolidated Financial Statements

Note 1 **Business and Organization**

Diamond Hill Investment Group, Inc. (the Company) derives its consolidated revenues and net income primarily from investment advisory and fund administration services that it provides to individual and institutional investors. The Company has four operating subsidiaries.

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

Diamond Hill GP (Cayman) Ltd. (DHGP) was incorporated in the Cayman Islands as an exempted company on May 18, 2006 for the purpose of acting as the general partner of a Cayman Islands exempted limited partnership. This limited partnership acts as a master fund for Diamond Hill Offshore Ltd., a Cayman Islands exempted company; and Diamond Hill Investment Partners II, L.P., an Ohio limited partnership. Diamond Hill GP (Cayman) Ltd. has no operating activity.

Beacon Hill Fund Services, Inc. (BHFS), an Ohio corporation, is a wholly owned subsidiary of the Company incorporated on January 29, 2008. BHFS provides certain compliance, treasury, and fund administration services to mutual fund companies. BHIL Distributors, Inc. (BHIL), an Ohio corporation, is a wholly owned subsidiary of BHFS incorporated on February 19, 2008. BHIL provides underwriting and distribution services to mutual fund companies. BHFS and BHIL collectively operate as Beacon Hill.

Note 2 **Significant Accounting Policies**

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

Principles of Consolidation

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

Segment Information

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

Cash and Cash Equivalents

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

Table of Contents

Note 2 Significant Accounting Policies (Continued)

Accounts Receivable

Accounts receivable are recorded when they are due and are presented in the balance sheet, net of any allowance for doubtful accounts. Accounts receivable are written off when they are determined to be uncollectible. Any allowance for doubtful accounts is estimated based on the Company's historical losses, existing conditions in the industry, and the financial stability of those individuals or entities that owe the receivable. No allowance for doubtful accounts was deemed necessary at December 31, 2010 or 2009.

Valuation of Investment Portfolio

Investments held by the Company are valued based upon the definition of Level 1 inputs and Level 2 inputs. Level 1 inputs are defined as fair values which use quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are defined as quoted prices in markets that are not considered to be active for identical assets or liabilities, quoted prices in active markets for similar assets or liabilities, and inputs other than quoted prices that are directly observable or indirectly through corroboration with observable market data. At December 31, 2010, \$1,265,998 and \$10,261,062 in Company investments are valued based upon Level 1 and Level 2 inputs, respectively. At December 31, 2009, \$4,108,170 and \$12,321,797 in Company investments are valued based upon Level 1 and Level 2 inputs, respectively. Level 1 investments are all registered investment companies (mutual funds). Level 2 investments are all limited partnerships. There are no transfers in or out of the levels.

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

Limited Partnership Interests

DHCM is the managing member of Diamond Hill General Partner, LLC, the General Partner of Diamond Hill Investment Partners, LP (DHIP), Diamond Hill Investment Partners II, LP (DHIP II), and Diamond Hill Research Partners, LP (DHRP), collectively (the Partnerships), each a limited partnership whose underlying assets consist of marketable securities.

DHCM, in its role as managing member of the General Partner, has the power to direct the Partnerships' economic activities and the right to receive investment advisory and performance incentive fees that are significant to the Partnerships. The Partnerships are subject to investment company accounting and, as a result, they have not been consolidated in presenting the accompanying financial statements. DHCM's investments in these partnerships are reported as a component of the Company's investment portfolio, valued at DHCM's proportionate interest in the net asset value of the marketable securities held by the Partnerships. Gains and losses attributable to changes in value of the DHCM's interests in the Partnerships are included in the Company's reported investment return.

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

Several board members, officers and employees of the Company invest in DHIP and DHIP II through Diamond Hill General Partner, LLC. These individuals receive no remuneration as a result of their personal investment in the Partnerships. The capital of Diamond Hill General Partner, LLC is not subject to a management fee or an incentive fee.

Table of Contents**Note 2 Significant Accounting Policies (Continued)****Furniture and Equipment**

Furniture and equipment, consisting of computer equipment, furniture, and fixtures, is carried at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over estimated lives of three to seven years.

Revenue Recognition – General

The Company earns substantially all of its revenue from investment advisory and fund administration services. Mutual fund investment advisory and administration fees, generally calculated as a percentage of assets under management, are recorded as revenue as services are performed. Managed account and private investment fund clients provide for monthly or quarterly management fees, in addition to quarterly or annual performance fees.

Revenue Recognition – Performance Incentive Revenue

The Company's private investment funds and certain managed accounts provide for performance incentive fees. For management fees based on a formula, there are two methods by which incentive revenue may be recorded. Under Method 1, incentive fees are recorded at the end of the contract period; under Method 2, the incentive fees are recorded periodically and calculated as the amount that would be due under the formula at any point in time as if the contract was terminated at that date. Management has chosen Method 1, in which incentive fees are recorded at the end of the contract period for the specific client in which the incentive fee applies. The table below shows assets under management (AUM) subject to performance incentive fees and the performance incentive fees, as calculated under each of the above methods:

		As Of December 31,		
		2010	2009	2008
AUM	Contractual Period Ends Quarterly	\$ 108,671,900	\$ 108,974,458	\$ 218,503,205
AUM	Contractual Period Ends Annually	175,231,841	196,469,025	159,514,591
Total AUM Subject to Performance Incentive		\$ 283,903,741	\$ 305,443,483	\$ 378,017,796

		For The Year Ending December 31,		
		2010	2009	2008
Performance Incentive Fees	Method 1	\$ 217,588	\$ 1,050,895	\$ 378,881
Performance Incentive Fees	Method 2	217,588	1,262,922	378,881

Revenue Recognition – Mutual Fund Administration

DHCM has an administrative and transfer agency services agreement with the Funds, under which DHCM performs certain services for each fund. These services include mutual fund administration, transfer agency and other related functions. For performing these services, each fund compensates DHCM a fee at an annual rate of 0.30% for Class A and Class C shares and 0.19% for Class I shares times each series' average daily net assets. Effective April 30, 2010, the fee for administrative services was decreased from 0.34% to 0.30% for Class A and Class C shares and from 0.20% to 0.19% for Class I shares. The Funds have selected and contractually engaged certain vendors to fulfill various services to benefit the Funds' shareholders or to satisfy regulatory requirements of the Funds. These services include, among others, required fund shareholder mailings, federal and state registrations, legal and audit. DHCM, in fulfilling a portion of its role under the administration agreement with the Funds, acts as agent to pay these obligations of the Funds. Each vendor is independently responsible for fulfillment of the services it has been engaged to provide and negotiates fees and terms with the management and board of trustees of the Funds. The fee that the Funds pay to DHCM is reviewed annually by the Funds' board of trustees and specifically takes into account the contractual expenses that DHCM pays on behalf of the Funds. As a result, DHCM is not involved in the delivery or pricing of these services and bears no risk related to these services. Revenue has been recorded net of these Fund expenses, as it is the appropriate accounting treatment for this agency relationship. In addition, DHCM finances the upfront commissions which are paid by the Fund's principal underwriter to brokers who sell Class C shares of the Funds. As financier, DHCM advances to the underwriter the commission amount to be paid to the selling broker at the time of

sale. These advances are capitalized and amortized over 12 months to correspond with the repayments DHCM receives from the principal underwriter to recoup this commission advancement.

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

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

Mutual fund administration gross and net revenue are summarized below:

	Year Ended December 31,		
	2010	2009	2008
Mutual fund administration:			
Administration revenue, gross	\$ 10,940,041	\$ 9,257,464	\$ 9,194,973
12b-1/service fees and commission revenue received from Fund clients	8,122,268	5,260,383	
12b-1/service fees and commission expense payments to third parties	(8,122,268)	(5,260,383)	
Fund related expense	(3,554,156)	(3,141,229)	(3,061,646)
Revenue, net of fund related expenses	7,385,885	6,116,235	6,133,327
DHCM C-Share financing:			
Broker commission advance repayments	619,490	763,383	1,776,206
Broker commission amortization	(549,838)	(789,639)	(1,755,614)
Financing activity, net	69,652	(26,256)	20,592
Mutual fund administration revenue, net	\$ 7,455,537	\$ 6,089,979	\$ 6,153,919

Third Party Distribution Expense

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

Income Taxes

The Company accounts for income taxes through an asset and liability approach. A net deferred tax asset or liability is determined based on the tax effects of the various temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

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

The Company has analyzed its tax positions taken on federal income tax returns for all open tax years (tax years ended December 31, 2007 through 2010) to determine any uncertainty in income taxes and has recognized no adjustment in the net asset or liability.

Earnings Per Share

Basic earnings per share (EPS) excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution of EPS that could occur if options and warrants were exercised.

Note 3 **Investment Portfolio**

As of December 31, 2010, the Company held investments worth \$11.5 million and a cost basis of \$7.6 million. The following table summarizes the market value of these investments for the last two fiscal years:

	As of December 31,	
	2010	2009
Diamond Hill Small Cap Fund	\$ 211,301	\$ 709,881
Diamond Hill Small-Mid Cap Fund	217,915	785,714
Diamond Hill Large Cap Fund	210,413	684,554
Diamond Hill Select Fund	221,491	705,790
Diamond Hill Long-Short Fund	206,312	606,800
Diamond Hill Strategic Income Fund	198,566	615,431
Diamond Hill Investment Partners, L.P.	1,177,098	2,653,856
Diamond Hill Investment Partners II, L.P.	1,155,022	2,649,665
Diamond Hill Research Partners, L.P.	7,928,942	7,018,276
Total Investment Portfolio	\$ 11,527,060	\$ 16,429,967

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

	As of December 31,		
	2010	2009	2008
Total partnership assets	\$ 173,007,238	\$ 188,716,374	\$ 196,021,226
Total partnership liabilities	32,855,190	40,583,059	33,056,747
Net partnership assets	140,152,048	148,133,315	162,964,479
DHCM's portion of net assets	10,261,062	12,321,797	11,262,409

	For the Year Ended December 31,		
	2010	2009	2008
Net partnership income (loss)	4,486,719	35,193,357	(75,625,562)
DHCM's portion of net income (loss)	939,265	4,634,391	(3,866,314)

DHCM's income from the Partnerships includes its pro-rata capital allocation and its share of an incentive allocation, if any, from the limited partners.

Table of Contents

Note 4 Capital Stock

Common Shares

The Company has only one outstanding class of securities, Common Shares.

Authorization of Preferred Shares

The Company's Articles of Incorporation authorize the issuance of 1,000,000 shares of blank check preferred shares with such designations, rights and preferences, as may be determined from time to time by the Company's Board of Directors. The Board of Directors is authorized, without shareholder approval, to issue preferred stock with dividend, liquidation, conversion, voting, or other rights, which could adversely affect the voting or other rights of the holders of the Common Shares. There were no shares of preferred stock issued or outstanding at December 31, 2010 or December 31, 2009.

Note 5 Stock-Based Compensation

Equity Incentive Plans

2005 Employee and Director Equity Incentive Plan

At the Company's annual shareholder meeting on May 12, 2005, shareholders approved the 2005 Employee and Director Equity Incentive Plan (2005 Plan). The 2005 Plan is intended to facilitate the Company's ability to attract and retain staff, provide additional incentive to employees, directors and consultants, and to promote the success of the Company's business. The 2005 Plan authorizes the issuance of Common Shares of the Company in various forms of stock or option grants. As of December 31, 2010 there were 291,883 shares available for issuance under the 2005 Plan. The 2005 Plan provides that the Board of Directors, or a committee appointed by the Board, may grant awards and otherwise administer the 2005 Plan. Restricted stock grants issued under the 2005 Plan, which vest over time, are recorded as deferred compensation in the equity section of the balance sheet on grant date and then recognized as compensation expense based on the grant date price over the vesting period of the respective grant.

Equity Compensation Grants

On May 13, 2004, the Company's shareholders approved terms and conditions of certain equity compensation grants to three key employees. Under the approved terms, a total of 75,000 shares of restricted stock and restricted stock units were issued to the key employees on May 31, 2004. These shares vested on October 3, 2008.

Accelerated Vesting of Certain Equity Incentive Plans and Compensation Grants

The Board of Directors of the Company approved the accelerated vesting of 82,064 shares of restricted stock from various vesting dates during the first five months of 2009 to October 3, 2008. This acceleration resulted in additional compensation expense of \$1.0 million in the fourth quarter of 2008 that otherwise would have been recorded in the first and second quarters of 2009. In addition, as a result of this acceleration, the Company received a \$6.3 million tax deduction in 2008.

401(k) Plan

The Company sponsors a 401(k) plan in which all employees participate. Employees may contribute a portion of their compensation subject to certain limits based on federal tax laws. The Company makes matching contributions of Common Shares of the Company with a value equal to 200 percent of the first six percent of an employee's compensation contributed to the plan. Employees become fully vested in the matching contributions after six plan years of employment. For the years ended December 31, 2010, 2009, and 2008, expenses attributable to the plan were \$869,680, \$758,522 and \$638,796, respectively.

Table of ContentsNote 5 Stock-Based Compensation (Continued)Stock Options and Warrants

The Company recognizes all share-based payments to employees and directors, including grants of stock options, as expense in the income statement based on their fair values. The amount of compensation is measured at the fair value of the options when granted, and this cost is expensed over the required service period, which is normally the vesting period of the options. As of December 31, 2010, there were no stock options or warrants outstanding.

Stock option and warrant transactions under the various plans for the past three fiscal years are summarized below:

	Options		Warrants	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Oustanding December 31, 2007	92,500	\$ 10.40	25,400	\$ 47.00
Exercisable December 31, 2007	72,500	\$ 12.03	25,400	\$ 47.00
Granted				
Expired / Forfeited			12,400	72.09
Exercised	92,500	10.40	3,000	56.67
Oustanding December 31, 2008		\$	10,000	\$ 13.00
Exercisable December 31, 2008		\$	10,000	\$ 13.00
Granted				
Expired / Forfeited				
Exercised			4,000	16.88
Oustanding December 31, 2009		\$	6,000	\$ 10.42
Exercisable December 31, 2009		\$	6,000	\$ 10.42
Granted				
Expired / Forfeited			4,000	10.00
Exercised			2,000	11.25
Oustanding December 31, 2010		\$		\$
Exercisable December 31, 2010		\$		\$

Note 6 Operating Leases

The Company leases approximately 21,200 square feet of office space at two locations. Total lease and operating expenses for the years ended December 31, 2010, 2009, and 2008 were \$573,218, \$501,209, and \$390,196, respectively. The approximate future minimum lease payments under the operating leases are as follows:

2011	2012	2013	2014	2015	Thereafter
------	------	------	------	------	------------

\$ 340,000 \$ 348,000 \$ 356,000 \$ 358,000 \$ 361,000 \$ 210,000

In addition to the above rent, the Company is also responsible for normal operating expenses of the properties. Such operating expenses were approximately \$9.97 per square foot in 2010, on a combined basis, and are expected to be approximately \$9.94 per square foot in 2011.

Table of ContentsNote 7 Income Taxes

The Company files a consolidated Federal income tax return. It is the policy of the Company to allocate the consolidated tax provision to subsidiaries as if each subsidiary's tax liability or benefit were determined on a separate company basis. As part of the consolidated group, subsidiaries transfer to the Company their current Federal tax liability or assets. The federal income tax benefit for 2008 includes interest and penalties paid of \$11 thousand.

	2010	2009	2008
Current city income tax provision	\$ 514,076	\$ 266,711	\$ 375,821
Current state income tax provision	147,642	44,000	11,000
Current federal income tax provision	6,966,872	4,358,283	4,396,824
Deferred federal income tax provision (benefit)	(352,509)	1,468,051	(2,535,960)
Provision for income taxes	\$ 7,276,081	\$ 6,137,045	\$ 2,247,685

A reconciliation of income tax expense at the statutory federal rate to the Company's income tax expense is as follows:

	2010	2009	2008
Income tax computed at statutory rate	\$ 6,887,483	\$ 5,990,509	\$ 1,898,479
City and state income taxes, net of federal benefit	430,117	204,417	255,302
Other	(41,519)	(57,881)	93,904
Income tax expense	\$ 7,276,081	\$ 6,137,045	\$ 2,247,685

Deferred tax assets and liabilities consist of the following at December 31, 2010 and 2009:

	2010	2009
Stock-based compensation	\$ 1,462,094	\$ 926,222
Unrealized (gains) losses	(1,205,681)	(1,742,009)
Capital loss carry forward	677,770	1,547,804
Other assets and liabilities	(60,709)	(211,052)
Net deferred tax assets	\$ 873,474	\$ 520,965

For the years ended December 31, 2010 and 2009, the Company received net federal tax benefits from the exercise of stock-based compensation of \$63,319 and \$119,204 respectively, which resulted in an increase to equity. As of December 31, 2007, the Company and its subsidiaries had a net operating loss (NOL) carry forward for tax purposes of approximately \$5,800,000. The NOL related to the exercise of stock options and warrants. The tax benefit of the NOL was fully utilized in 2008 and was recognized in equity in 2008.

Table of Contents**Note 8 Earnings Per Share**

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

	Year Ended December 31,		
	2010	2009	2008
Basic and Diluted net income	\$ 12,402,441	\$ 11,373,943	\$ 3,276,078
Weighted average number of outstanding shares			
Basic	2,766,741	2,582,998	2,400,142
Diluted	2,767,895	2,587,751	2,408,476
Earnings per share			
Basic	\$ 4.48	\$ 4.40	\$ 1.36
Diluted	\$ 4.48	\$ 4.40	\$ 1.36

Note 9 Regulatory Requirements

BHIL, a wholly owned subsidiary of the Company and principal underwriter for mutual funds, is subject to the U.S. Securities and Exchange Commission (SEC) uniform net capital rule, which requires the maintenance of minimum net capital. BHIL s net capital exceeds its minimum net capital requirement at December 31, 2010 and 2009. The net capital balances, minimum net capital requirements, and ratio of aggregate indebtedness to net capital for BHIL are summarized below as of December 31, 2010 and 2009:

	Year Ended December 31,	
	2010	2009
Net Capital	\$ 86,107	\$ 279,718
Minimum Net Capital Requirement	35,667	132,199
Ratio of Aggregate Indebtedness to Net Capital	8.79 to 1	7.09 to 1

Note 10 Commitments and Contingencies

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

Table of Contents

ITEM 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosures

None.

ITEM 9A. 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 of 1934) as of the end of the period covered by this report (the Evaluation Date). Based on such evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the 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.

There have been no changes in the Company's internal control over financial reporting during the year ended December 31, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Annual Report on Internal Control Over Financial Reporting

Management of Diamond Hill Investment Group, Inc. (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) and 15d-15(f) of the Exchange Act. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of its consolidated financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of the Chief Executive Officer and the Chief Financial Officer, management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2010 based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2010.

The Company's independent registered public accounting firm, Plante & Moran, PLLC, has audited the Company's 2010 and 2009 consolidated financial statements included in this Annual Report on Form 10-K and the Company's internal control over financial reporting as of December 31, 2010, and has issued its Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements, which is included in this Annual Report on Form 10-K.

Table of Contents**ITEM 9B. Other Information**

None.

PART III**ITEM 10. Directors, Executive Officers and Corporate Governance**

Information required by this Item 10 is incorporated herein by reference from the Company's definitive proxy statement for its 2011 annual meeting of shareholders to be filed with the SEC pursuant to Regulation 14A of the Exchange Act (the 2011 Proxy Statement), under the captions: Proposal 1 Election of Directors, Executive Officers and Compensation Information, Corporate Governance, and Section 16(a) Beneficial Ownership Reporting Compliance.

ITEM 11. Executive Compensation

Information required by this Item 11 is incorporated herein by reference from the Company's 2011 Proxy Statement under the captions: Executive Officers and Compensation Information and Corporate Governance.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table sets forth certain information concerning our equity compensation plans at December 31, 2010:

Equity Compensation Plan Information

	(a)	(b)	(c)
	Number of securities to be issued upon the exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Plan category			
Equity compensation plans approved by security holders		\$	291,883 ¹

1 This amount relates to common shares that may be issued under our 2005 Employee and Director Equity Incentive Plan. The maximum aggregate number of common shares that may be issued under our 2005 Employee and Director Equity Incentive Plan is annually increased on December 31 by an amount equal to the lesser of (i) 100,000 common shares, (ii) 5% of the Company's total outstanding common shares on such date, or (iii) a lesser amount determined by the Board of Directors.

The other information required by this Item 12 is incorporated herein by reference from the Company's 2011 Proxy Statement under the captions: Security Ownership of Certain Beneficial Owners and Management and Executive Officers and Compensation Information.

Table of Contents

ITEM 13. Certain Relationships and Related Transactions, and Director Independence

Information required by this Item 13 is incorporated herein by reference from the Company's 2011 Proxy Statement under the caption: Corporate Governance .

ITEM 14. Principal Accounting Fees and Services

Information required by this Item 14 is incorporated herein by reference from the Company's 2011 Proxy Statement under the caption: Independent Registered Public Accounting Firm .

Table of Contents

PART IV

ITEM 15. Exhibits, Financial Statement Schedules

- (a) (1) Financial Statements: See Part II. Item 8, Financial Statements and Supplementary Data .
- (2) Financial Statement Schedules: All financial statement schedules for which provision is made in the applicable accounting regulations of the SEC are omitted because they are not required or the required information is included in the accompanying financial statements or notes thereto.
- (3) Exhibits:
- 3.1 Amended and Restated Articles of Incorporation of the Company. (Incorporated by reference from Exhibit 3(i) to the Current Report on Form 8-K filed with the SEC on May 7, 2002; File No. 000-24498.)
 - 3.2 Regulations of the Company. (Incorporated by reference from Exhibit 3(ii) to the Current Report on Form 8-K filed with the SEC on May 7, 2002; File No. 000-24498.)
 - 10.1 Representative Investment Management Agreement between Diamond Hill Capital Management, Inc. and the Diamond Hill Funds. (Incorporated by reference from Exhibit 23d(viii) to Post-Effective Amendment Nos. 22 and 23 to Registration Statement on Form N1-A (File Nos. 333-22075 and 811-08061) filed by Diamond Hill Funds on December 30, 2005)
 - 10.2 Seventh Amended and Restated Administrative and Transfer Agency Services Agreement dated as of May 31, 2002, as amended, between Diamond Hill Capital Management, Inc. and the Diamond Hill Funds. (Incorporated by reference from Exhibit 28h(ix) to Post-Effective Amendment Nos. 28 and 29 to Registration Statement on Form N1-A (File Nos. 333-22075 and 811-08061) filed by Diamond Hill Funds on April 30, 2009)
 - 10.3* Amended and Restated 2005 Employee and Director Equity Incentive Plan. (Incorporated by reference from Exhibit 10.6 to Form 10-K filed with the SEC on March 14, 2008; File No. 000-24498.)
 - 10.4* 2005 Employee and Director Equity Incentive Plan First Amendment dated November 2, 2010 and Form of Restricted Stock Agreement reference therein. (Filed herewith)
 - 10.5* Amended and Restated 2006 Performance-Based Compensation Plan. (Incorporated by reference from Exhibit 10.7 to Form 10-K filed with the SEC on March 14, 2008; File No. 000-24498.)
 - 10.6* Amended and Restated Employment Agreement between the Company and Roderick H. Dillon, Jr. dated August 10, 2006. (Incorporated by reference from Exhibit 10.8 to Form 10-K filed with the SEC on March 14, 2008; File No. 000-24498.)
 - 10.7* First Amendment to the Amended and Restated Employment Agreement between the Company and Roderick H. Dillon, Jr. dated December 2, 2008. (Incorporated by reference from Exhibit 10.6 to Form 10-K filed with the SEC on March 13, 2009; File No. 000-24498.)
 - 10.8* Form of Participation Agreement to the Amended and Restated 2006 Performance-Based Compensation Plan. (Incorporated by reference from Exhibit 10.7 to Form 10-K/A filed with the SEC on January 29, 2010; File No. 000-24498.)
 - 14.1 Amended Code of Business Conduct and Ethics. (Incorporated by reference from Exhibit 14.1 to Form 10-K filed with the SEC on March 13, 2009; File No. 000-24498.)
 - 21.1 Subsidiaries of the Company. (Filed herewith)
 - 23.1 Consent of Independent Registered Public Accounting Firm, Plante & Moran, PLLC. (Filed herewith)
 - 31.1 Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a). (Filed herewith)
 - 31.2 Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a). (Filed herewith)
 - 32.1 Section 1350 Certifications. (Furnished herewith)

- * Denotes management contract or compensatory plan or arrangement.
- (b) Exhibits: Reference is made to Item 15(a)(3) above.
- (c) Financial Statement Schedules: None required.

Table of Contents**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized:

DIAMOND HILL INVESTMENT GROUP, INC.

By: /S/ R. H. Dillon

February 25, 2011

R. H. Dillon, President, Chief Executive Officer and a Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/S/ R. H. Dillon R. H. Dillon	President, Chief Executive Officer, and a Director	February 25, 2011
/S/ James F. Laird James F. Laird	Chief Financial Officer, Treasurer, and Secretary	February 25, 2011
/S/ Gary R. Young Gary R. Young	Controller	February 25, 2011
/S/ Lawrence E. Baumgartner Lawrence E. Baumgartner	Director	February 25, 2011
/S/ David P. Lauer David P. Lauer	Director	February 25, 2011
/S/ Frances A. Skinner Frances A. Skinner	Director	February 25, 2011
/S/ David R. Meuse David R. Meuse	Director	February 25, 2011
/S/ Diane D. Reynolds Diane D. Reynolds	Director	February 25, 2011
/S/ Donald B. Shackelford Donald B. Shackelford	Director	February 25, 2011

