

DIAMOND HILL INVESTMENT GROUP INC  
Form 10-K  
February 21, 2019  
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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, 2018  
Commission file number 000-24498

DIAMOND HILL INVESTMENT GROUP, INC.

(Exact name of registrant as specified in its charter)

Ohio 65-0190407  
(State of (I.R.S. Employer  
incorporation) Identification No.)  
325 John H. McConnell Blvd., Suite 200, 43215  
Columbus, Ohio 43215  
(Address of principal executive offices) (Zip Code)  
Registrant's telephone number, including area code: (614) 255-3333  
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 every Interactive Data File required to be submitted 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 such files). Yes  No

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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  x

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

Large accelerated filer  Accelerated filer  x

Non-accelerated filer  Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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 \$194.43 on June 30, 2018 on the NASDAQ Global Select Market was \$648,693,724. Calculation of holdings by non-affiliates is based upon the assumption, for these purposes only, that the registrant's executive officers and directors are affiliates.

The number of shares outstanding of the issuer's common stock, as of February 20, 2019, is 3,500,730 shares.

Documents Incorporated by Reference

Portions of the registrant's definitive proxy statement for the 2019 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 Annual Report on Form 10-K.

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PART I

Item 1. Business

Forward-Looking Statements

Throughout this Annual Report on Form 10-K, Diamond Hill Investment Group, Inc. ("Diamond Hill") 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, including, but not limited to, statements regarding anticipated operating results, prospects and levels of assets under management, technological developments, economic trends (including interest rates and market volatility), expected transactions and similar matters. The words "believe," "expect," "anticipate," "target," "project," "estimate," "should," "hope," "seek," "plan," "intend," variations of such words and expressions identify such forward-looking statements, which speak only as of the date made. While we believe that the assumptions underlying our forward-looking statements are reasonable, investors are cautioned that any of the assumptions could prove to be inaccurate and, accordingly, our actual results and experiences could differ materially from the anticipated results or other expectations expressed in our forward-looking statements. Factors that could cause such actual results or experiences to differ from results discussed in the forward-looking statements include, but are not limited to: the adverse effect from a decline in the securities markets; a decline in the performance of our products; changes in interest rates; changes in national and local economic and political conditions; the continuing economic uncertainty in various parts of the world; changes in government policy and regulation, including monetary policy; changes in our ability to attract or retain key employees; unforeseen costs and other effects related to legal proceedings or investigations of governmental and self-regulatory organizations; and other risks identified from time-to-time in other public documents on file with the U. S. Securities and Exchange Commission ("SEC"), including those discussed below in Item 1A. Throughout this Annual Report on Form 10-K, when we use the terms the "Company," "management," "we," "us," and "our," we mean Diamond Hill and its subsidiaries.

Overview

Diamond Hill, an Ohio corporation organized in April 1990, derives its consolidated revenue and net income from investment advisory and fund administration services provided by its wholly owned subsidiary, Diamond Hill Capital Management, Inc. ("DHCM"). DHCM is a registered investment adviser under the Investment Advisers Act of 1940. DHCM sponsors, distributes, and provides investment advisory and related services to clients through Diamond Hill Funds (the "Funds"), institutional accounts, an exchange traded fund, and private investment funds. In July of 2016, the Company sold two former wholly owned operating subsidiaries, Beacon Hill Fund Services, Inc. ("BHFS") and BHIL Distributors, Inc. ("BHIL" and collectively "Beacon Hill"). Until its sale, Beacon Hill provided fund administration and statutory underwriting services.

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

Investment Advisory Activities

Clients

The Company provides investment advisory services to a broad range of clients, including corporations, mutual funds, retirement plans, public pension funds, endowments, foundations, financial institutions and high net worth individuals. We strive to expand our client base by attracting new clients and earning additional business from existing clients.

Investment Philosophy

We believe intrinsic value is independent of market price and that competitive long-term returns can be achieved by identifying meaningful differences between the two. We believe we can identify those market opportunities with a bottom-up, intrinsic value-focused approach to active investment management. As a result, our investment strategy is driven by individual security decisions rather than by a macro-economic focus.

Investment Process

DHCM's equity investment process begins with fundamental research focusing on estimating a company's intrinsic value independent of its current stock price. Bottom-up analysis, described in further detail below, is of primary importance in estimating the intrinsic value of an individual company. Our research analysts also evaluate each company within the context of sector and industry secular trends. A five-year discounted cash flow analysis is the primary methodology we use to determine whether there is a discrepancy between the current market price and

DHCM's estimate of intrinsic value. The key factors in determining the intrinsic value through are normalized earnings and earnings growth rate, payout ratio and dividends, terminal earnings multiple, and required rate of return. We will invest when we believe that we can make informed judgments about, and

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estimates of, those cash flows and when our estimate of intrinsic value provides a margin of safety relative to the current market price. We assign the highest portfolio weights where we have the highest conviction. Within stated diversification constraints, we are willing to take outsized positions in our highest conviction ideas. Benchmark weights are not a consideration.

DHCM also applies an intrinsic value philosophy and process to the analysis of fixed income securities. For our Short Duration Total Return and Core Bond strategies, our investment process is driven by security selection, sector allocation, yield curve positioning, and duration management in concert with overall portfolio management. We seek to generate excess return through the selection of undervalued securities and spread sectors that offer incremental yield and total return in comparison to the index. The hallmark of our process is the selection of individual issues with an emphasis on identifying undervalued securities. Individual securities are selected following a risk/reward evaluation of interest rate and credit risk, and an examination of the complex and technical structure of the security. We only purchase those securities that we identify as undervalued and offer a strong total return profile relative to similar securities.

For our Corporate Credit and High Yield strategies, we leverage the industry analysis conducted by our research team to identify attractive corporate bonds. We seek to invest in bonds of companies with improving return on invested capital and stable or improving competitive positions. We work closely with our research team to understand the fundamental economic drivers of the business and to assess whether there is adequate financial strength and flexibility to meet ongoing commitments. Our research analysts consider debt instruments as part of their analysis. After the credit research is complete, our portfolio managers determine whether a security is attractive on a yield basis relative to asset and interest coverage and relative to other securities with comparable risk. We will only own the bonds of a company that we can analyze and value.

DHCM believes that many investors' short-term focus hinders their long-term results, which creates market inefficiencies and therefore opportunities. In addition, the size and complexity of the fixed income markets also creates inefficiencies. We believe that we can exploit these market anomalies/inefficiencies by possessing a long-term investment temperament and practicing a consistent and repeatable intrinsic value-focused approach to investing.

### Investment Advisory Fees

The Company's principal source of revenue is investment advisory fee income earned from managing client accounts under investment advisory and sub-advisory agreements. The fees earned depend on the type of investment strategy, account size and servicing requirements. Revenues depend on the total value and composition of assets under management ("AUM"). Accordingly, net cash flows from clients, market fluctuations in client portfolios, and the composition of AUM impact our revenues and results of operations. We also have certain agreements which allow us to earn variable rate fees in the event that investment returns exceed targeted amounts during a measurement period.

### Investment Strategies

The Company offers several traditional and alternative investment strategies, which are all based on the same intrinsic value philosophy. As of December 31, 2018, we offered the following representative investment strategies to our clients:

1. Small Cap - Pursues long-term capital appreciation by investing in a portfolio of primarily small capitalization U.S. equity securities.
2. Small-Mid Cap - Pursues long-term capital appreciation by investing in a portfolio of primarily small and medium capitalization U.S. equity securities.
3. Mid Cap - Pursues long-term capital appreciation by investing in a portfolio of primarily medium capitalization U.S. equity securities.
4. Large Cap - Pursues long-term capital appreciation by investing in a portfolio of primarily large capitalization U.S. equity securities.
5. All Cap Select - Pursues long-term capital appreciation by investing in a concentrated portfolio of primarily U.S. equity securities across a broad range of market capitalizations.
6. Global - Pursues long-term capital appreciation by investing in U.S. and foreign equity securities across a broad range of market capitalizations including up to 20% exposure to emerging markets.
- 7.

Long-Short - Pursues long-term capital appreciation by investing long and selling short primarily U.S. equity securities across a broad range of market capitalizations.

Research Opportunities - Pursues long-term capital appreciation by investing long and selling short U.S. equity securities across a broad range of market capitalizations, as well as by investing up to 40% in international equity securities and up to 20% in fixed income securities.

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9. Financial Long-Short - Pursues long-term capital appreciation by investing long and selling short primarily U.S. financial services equity securities across a broad range of market capitalizations.
10. Valuation-Weighted 500 - Pursues long-term capital appreciation by investing in large capitalization U.S. equity securities that seek to track the price and total return of the Diamond Hill Valuation-Weighted 500 Index.
11. Short Duration Total Return - Pursues maximization of total return consistent with the preservation of capital by investing in high, medium, and low-grade fixed income securities.
12. Core Bond - Pursues maximization of total return consistent with the preservation of capital by investing in a diversified portfolio of intermediate and long-term fixed income securities.
13. Corporate Credit - Pursues high current income, preservation of capital, and total return over a five-year time horizon by investing primarily in corporate bonds across the credit spectrum.
14. High Yield - Pursues high current income with the opportunity for capital appreciation by investing primarily in below-investment grade corporate bonds.

Investment Results

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. We are pleased that during our history as an investment advisory firm, we have delivered what we believe are strong long-term investment returns for our clients. Investment returns have been a key driver in the long-term success we have achieved in growing AUM.

As of December 31, 2018, the since-inception returns for most of our strategies exceeded their respective benchmark returns. Our Mid Cap strategy reached its five-year track record at the end of 2018 and we launched the Diamond Hill Global Fund in January 2018. As always, we remain focused on five-year periods to evaluate our results.



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The following is a summary of the investment returns for each of our Funds as of December 31, 2018, relative to its respective passive benchmark.

	As of December 31, 2018						
	Inception	1 Year	3 Year	5 Year	10 Year	Since Inception	
Diamond Hill Small Cap Fund	12/29/2000	(14.88)%	2.62%	1.81%	9.94%	9.39%	%
Russell 2000 Index		(11.01)%	7.36%	4.41%	11.97%	7.29%	%
Diamond Hill Small-Mid Cap Fund	12/30/2005	(12.56)%	3.93%	4.07%	12.88%	7.58%	%
Russell 2500 Index		(10.00)%	7.32%	5.15%	13.15%	7.50%	%
Diamond Hill Mid Cap Fund	12/31/2013	(10.31)%	5.51%	5.01%	NA	5.01%	%
Russell Midcap Index		(9.06)%	7.04%	6.26%	NA	6.26%	%
Diamond Hill Large Cap Fund	6/29/2001	(9.63)%	7.61%	6.47%	11.97%	7.81%	%
Russell 1000 Index		(4.78)%	9.09%	8.21%	13.28%	6.50%	%
Diamond Hill All Cap Select Fund	12/30/2005	(12.02)%	5.09%	5.06%	11.59%	7.07%	%
Russell 3000 Index		(5.24)%	8.97%	7.91%	13.18%	7.72%	%
Diamond Hill Long-Short Fund	6/30/2000	(7.04)%	2.89%	2.93%	6.59%	6.12%	%
60% Russell 1000 Index / 40% ICE BofAML U.S. T-Bill 0-3 Mo Index							