

**DIAMOND HILL INVESTMENT GROUP, INC.**  
ANNUAL LETTER TO SHAREHOLDERS

March 12, 2014

Dear Fellow Shareholders:

The asset management industry is not complex but neither is it easy, especially as an active manager. Our fiduciary responsibility to our clients is crystal clear. We fulfill that responsibility by providing investment strategies that we believe will deliver long-term value to our clients' portfolios and then by communicating accurately the degree to which we have succeeded in that endeavor.

Similarly, our corporate goal is to provide a return to our owners commensurate with the risk of our enterprise. This is measured by the capital returned to shareholders and the growth in the intrinsic value per share.

I am pleased that, since inception, we have generally met this dual mission of delivering value to our clients and to our shareholders. Going forward, while our mission remains clear, it continues to be challenging as we experience countervailing winds: the benefit of more resources, offset by larger assets under management (AUM). Therefore, continuous improvement is required in all areas of the firm.

### **Firm Sustainability**

Succession planning is one of the most important responsibilities of any firm, and we made significant progress in 2013. Late last year, Chris Bingaman was named President of Diamond Hill Capital Management, Inc., and Lisa Wesolek was named Chief Operating Officer. Chris and Lisa are among the people who will be the future executive leadership and in fact already have increasing influence on the management of the firm as members of the Senior Management Team appointed in December 2012. As a portfolio manager, Chris understands the importance of our fiduciary responsibility and will maintain our primary investment focus. Given the competitive nature of our industry, client service and retention is also important to our future growth and sustainability, and Lisa's experience will be invaluable.

It is expected that Chris will succeed me as Chief Executive Officer in January 2016. As I wrote in the Diamond Hill annual shareholder letter in March 2011, I intend to continue to serve as a portfolio manager after that time. In addition, effective January 1, 2014, I assumed the role of Vice Chairman of the Diamond Hill Investment Group Board, and it is expected that I will succeed Don Shackelford as Board Chairman in 2015 when his term expires.

Attracting and retaining talented investment personnel is also key to firm sustainability. Our research team has continued to grow in numbers and experience, led by Co-Directors of Research Rick Snowdon and Austin Hawley. At the end of 2013, we had 17 research analysts and 7 research associates, which we believe necessary for the depth of analysis required to accomplish our goals. The growth of this team has paralleled the growth in AUM, and we hope to see continued growth in both. Importantly, we have had no turnover in our equity portfolio manager or our research analyst ranks since the firm's inception.

Co-Chief Investment Officer Chris Welch leads our newest strategy, which is a Mid Cap strategy that overlaps with Chuck Bath's Large Cap strategy and Chris' own Small-Mid Cap strategy. We believe that this offering addresses an important market segment and can be managed efficiently given our existing strategies. We will only offer strategies in areas where we believe we can meet our fiduciary responsibility to new clients without diminishing our ability to meet that responsibility to our clients in existing strategies.

At the end of 2013, we completed an initiative to refresh our brand, including a new logo and website. Each of the colors in our new logo was carefully chosen to represent one of the core principles in our mission statement, serving as a subtle yet tangible reminder of our commitment and our distinctive culture. Our commitment to an intrinsic value-based investment philosophy, long-term perspective, disciplined approach, and alignment with our clients' interests remains unchanged, as it has since our firm's inception.

### **Financial Results: Shareholder Value**

Revenue was \$81 million in 2013 compared with \$67 million in 2012 and \$47 million in 2008. AUM finished the year at \$12.2 billion, up 30% from 2012 and 170% from 2008. Our 37.7% operating margin was slightly higher than last year's margin of 36.6%. Our strong financial results in 2013 were primarily a reflection of the very strong U.S. equity markets. The U.S. financial markets have rebounded considerably from the depths of the financial crisis. As a result, we believe it is highly unlikely that equity market returns will rival returns over the past five years, which certainly impacts our growth in revenues and profits.

Six years ago, Diamond Hill paid its first cash dividend, and we have paid a cash dividend each year since. In total, we have paid \$49 per share in cash dividends, about 57% of which represented a return of capital. It is important to note that during the past six years, our tangible book value per share declined due to these dividends, from \$17.52 at the end of 2007 to \$13.80 at the end of 2013. The \$49 per share in dividends and the \$3.72 decline in tangible book value per share results in a net of \$45.28 per share, which represents one measure of change in shareholder value during the past six years, an annualized rate of 17% percent for the six years. While tangible book value is a component of intrinsic value, the percentage of intrinsic value it represents varies considerably between companies.

This analysis is comparable to another popular measure: total shareholder return (TSR), which takes into account both cash returned to shareholders and change in stock price. For Diamond Hill, this also equates to approximately 15% annualized over the past six years. While the current stock price represents the market's estimate of a company's intrinsic value, a premise of our investment philosophy is that price and intrinsic value often differ, sometimes substantially. Thus, we believe the relevant measure of value creation, in addition to cash returned to shareholders, is the change in Diamond Hill's intrinsic value.

### **The Next Five Years**

During the next five years, and always, our top priority is to meet our fiduciary duty to clients. Adding value to our clients' portfolios through our disciplined investment process is imperative for retaining and growing our client base. Secondly, adding new strategies that fit well with our existing strategies, like our new Mid Cap strategy, is something we will consider. Over the past few years, we have expanded our research effort to include more international companies. A deeper understanding of non-U.S. based companies not only allows us to be better investors, but also may lead to a global strategy in the future. Finally, additional tangential business

opportunities, like our Beacon Hill subsidiary, are possible, but only when we believe that such opportunities would increase the intrinsic value of our entire firm.

We are a financially strong, well-positioned firm operating in a very competitive industry. While I would not want us to underestimate the various challenges, I believe that we will continue to build upon our past successes and to reward clients, shareholders, and associates accordingly. A special thanks to our Board of Directors who have supported me in those efforts.

Sincerely,

A handwritten signature in black ink that reads "R. H. Dillon". The letters are cursive and slightly slanted to the right.

R. H. Dillon  
President and Chief Executive Officer