DIAMOND HILL investments

April 6, 2005

Dear Fellow Shareholders,

The 2005 annual meeting on May 12th coincides with the date five years ago when we embarked on the construction of what is now known as Diamond Hill Investment Group. At the outset, our mission was two-fold, which was to:

- build an investment management firm that ranks among the best, and
- rationalize the existing businesses.

In the first five years of this journey, we have built a solid foundation to achieve our mission. Importantly, this has been accomplished in a manner such that the shareholders intrinsic value per share has risen at least two-fold, during a difficult period for U.S. equity markets generally and the investment management industry in particular.

The best investment management firms are characterized by:

- excellent investment returns for their clients over a long period of time,
- dedication to a sound, proven investment philosophy, and
- personnel who exhibit integrity, intelligence, and energy.

Ten years may be the minimum definition of "a long period of time" and therefore we are near the halfway point in this quest (in terms of calendar years, we have completed four). It is gratifying that in each year we have had solid investment returns for all of our strategies, and the cumulative period ranking is especially good. For instance, while the S&P 500 had a negative return of -13% during the period July 1, 2000 through March 26, 2005, our first fund, the Diamond Hill Focus Long-Short Fund, had a positive return of 49%.

However, we cannot rest on our laurels. Many clients are new to us, and therefore they have not benefited from our past successes. Our goal is for each of our investment strategies to be ranked in the top quartile for the next five-year period ending December 31, 2009 (and to continue doing so in subsequent rolling five-year periods).

As a corporation, another characteristic to be among the "best in class" would be growth in shareholder intrinsic value, with profitability an important guidepost. A survey of publicly owned firms might suggest "scale" is achieved at a 30% operating profit margin. As we approach the operating cash flow breakeven mark, we still need to grow our business substantially to reach that level. [In last year's letter I suggested assets under management ("AUM") in a range of $2 to $4 billion necessary to achieve scale.] As of March 25th AUM were about $675 million, more than twice the level of a year ago.

Our financial goals during the next five years include:

- annual improvement in operating profit margins, reaching 30% by 2009,
- full utilization of our tax loss carry-forwards, and
- recouping our subsidy of our mutual funds' administration expenses.

Achieving these goals would result in strong growth in our company's intrinsic value per share. Most importantly, fulfilling our fiduciary responsibility through competitive investment returns and service will always be our primary goal as an investment firm.

As Benjamin Graham taught Warren Buffett (among others, including us who read Graham's books and Buffett's shareholder letters), intrinsic value is the "true value" of the shareholder equity of a company. For an ongoing concern, the intrinsic value is unknowable by definition, calculated as the present value of some measure of future cash flows. All we humans can do is estimate the future, and thus estimate the intrinsic value. The accounting concept of book value, or the current trading price for a share of common stock may or may not approximate an independent estimate of intrinsic value.

Our firm's investment management philosophy is to have an estimate of intrinsic value before purchasing shares for our client portfolios, and then to constantly compare the stock price with that estimate of intrinsic value. We look to sell those stocks whose market prices exceed our estimate, believing that holding stocks that are trading above our estimate departs the investing realm, and enters the world of speculation.

How does the above discussion of intrinsic value apply to shareholders of Diamond Hill? Hindsight being 20/20, when I estimate the intrinsic value per share for our company in May 2000, I conclude that the value was $5-6 per share. This approximated tangible book value, and was lower than the $8-9 trading range on May 12, 2000.

Estimating our current intrinsic value might begin with forecasts of our EPS for each of the next five years. A wide range of possibilities exist, dependant upon variables such as:

- our clients' investment results,
- the success of our business development efforts, and
- general expense controls.

Our stock's recent trading range may imply achieving scale in the next five years. Stated differently, not reaching scale until 2014 implies a lower intrinsic value per share as compared with the intrinsic value assuming achieving scale in 2009. That being said, it is most important that we focus on growing the intrinsic value of the company, believing that over time the stock price will ultimately reflect that value.

I conclude by thanking the Board of Directors and my colleagues at the company for the opportunity to have served as your President and Chief Executive Officer these past five years. I believe we are poised for an exciting and profitable future.

Sincerely,

Ric

R.H. Dillon
President and Chief Executive Officer