



## DIAMOND HILL INVESTMENTS ANNUAL LETTER TO SHAREHOLDERS

April 8, 2008

Dear Fellow Shareholders,

“In the long run, delivering excellent investment results for our clients will help to generate growth for our business and attract new clients and additional investments for us to manage.” That may sound familiar to you, and I hope it does because it is the opening sentence from my letter in 2007. I repeat it because I think it states very clearly that our primary objective is to deliver on our promise to clients and because we understand that if we deliver excellent investment results for clients we will most likely grow our business, which helps to satisfy our responsibility to our shareholders.

A focus on the long term is fundamental to everything we do at Diamond Hill. We use rolling five-year periods in quarterly increments for estimating the intrinsic value of securities, and also for measuring the results of our various portfolio strategies. We hire people based on our sense of how they will contribute over the long term, and we seek investors who share our long-term perspective. Interestingly, we operate in an investment environment where many participants talk about the long term but whose actions seem to indicate a short-term orientation. In 2007, for example, we saw our rate of growth slow significantly as the relative performance of our long-short portfolios underperformed for the year, despite an exceptional long-term performance record. We understand this phenomenon, and we are prepared to deal with the consequences of it, but we will never allow the short-term orientation of others to impact our fundamental focus on the long term.

### 2007 review

The U.S. stock market was up modestly in 2007 – the fifth consecutive year of positive returns for equities. Cumulative gains peaked around mid-year, as problems related to the “housing bubble” revealed in the second half of the year caused much concern, particularly in the financial sector of the economy. Our strategies had mixed results for the calendar year; however, over a five-year period the results continue to be excellent. Our primary corporate objective is to meet our fiduciary duty to clients. Consequently, we are pleased that returns for our clients over the past five years meet this objective.

Not surprisingly, our mixed results coupled with the financial sector concerns led to a slowdown in the growth of new assets under management (AUM). Having begun the year at \$3.7 billion in AUM, we reached \$4.4 billion by mid-year and then essentially leveled off for the remainder of the year. While we did attract new client assets in the second half, those were offset by concurrent market value declines and some outflows.

Revenues rose to \$41 million for 2007 compared with \$32 million in 2006, and our operating profit margin rose to 34% versus 31%, both new highs for the company. These are important metrics for estimating our company’s intrinsic value, which I believe grew for the seventh consecutive year.

### Building the firm

Building a company that is labor intensive (as opposed to capital intensive) requires attracting and retaining the talented people necessary for various roles in the enterprise. Staffing continued to expand meaningfully in 2007, and for the fifth consecutive year, we had no departures (but one retirement). Much effort and many resources are committed to enhancing our culture and working atmosphere, and these intangibles are also important in growing the intrinsic value of a business. Our marketing and support staff has grown, which should enable us to expand the number of clients and financial intermediaries we can serve. Also very importantly we continue to add talented individuals to our research analyst group, and I think we are developing a research team that will contribute meaningfully to our clients' investment results, and possibly allow us to expand our strategy offerings. I believe that research is critical to our future. The growth of our research team gives us the additional capacity to follow more companies as potential investments and to build a greater knowledge base and expertise in more industries, which we have confidence will enhance future returns for our clients.

Another intangible is the reputation of the company. Last year our mutual fund family ranked among the very best for stewardship, with an "A" from Morningstar. Morningstar's stewardship grade represents its analysts' evaluation of a fund's corporate culture, board quality, portfolio manager incentives, fees and regulatory history. More than 1,000 funds were evaluated by Morningstar and just 6% of funds received an "A" grade. We believe this validates our client-centric mission and communicates to prospective clients that we take our role as a fiduciary most seriously.

In my March 2007 letter I discussed at length a number of topics that should be of interest to shareholders including our views on the economics of our business and the balancing between owners and employees, a discussion of our objective of growing the intrinsic value of the firm over time, and our views on dividends and stock splits. The letter is archived on our web site at [www.diamond-hill.com](http://www.diamond-hill.com) along with a number of other documents that describe and explain our investment and business philosophies. I strongly urge each shareholder to review my 2007 letter to become familiar with our positions on these important topics.

I am very grateful to all my associates at Diamond Hill. I can honestly say that each member of our team is talented, and I truly enjoy working together with them. Special mention is appropriate for the contributions made by our team of portfolio managers, including Chuck Bath, Chris Bingaman, Bill Dierker, Kent Rinker, Tom Schindler, Chris Welch and Bill Zox. Their experience, skill and leadership are invaluable. Particular note is offered to Chuck and the Large Cap Fund he manages, which ranks among the very best for the five years he has been at the helm, far exceeding the returns for some better known competitors. Chuck's contribution to other strategies has been very important as well, and it is accurate to say that his cumulative efforts during the past five years have added significant value to what Diamond Hill is today.

Again, I would like to thank all my colleagues and our Board of Directors for their efforts and support and reaffirm that all of us at Diamond Hill Investment Group will continue our mission to build an excellent investment management firm for clients and owners alike.

Sincerely,



R. H. Dillon  
Chief Executive Officer