



DIAMOND HILL INVESTMENT GROUP, INC. ANNUAL LETTER TO SHAREHOLDERS

March 12, 2021

Dear Fellow Shareholders:

At Diamond Hill, our primary purpose is to improve our clients' lives through better financial outcomes. That commitment is evident in our vision—to be an exceptional, active investment boutique that our clients trust to deliver excellent long-term investment outcomes from a team aligned with their success.

Our industry has faced significant headwinds over the past decade—in part because investors are rightly demanding greater value for fees paid. Superior investment results, while a critical part of our success, are no longer enough. Clients are demanding more transparency, greater accountability and more targeted communication—a client experience that addresses their specific needs from a long-term partner they can trust. We believe the best way to build that trust and deliver on our purpose and vision is through our aligned boutique model (explained below), by fostering an investment culture where clients come first, and by ensuring every associate is committed to upholding our values of curiosity, ownership, trust and respect.

An Aligned Boutique Model Fosters Our Client-Centric Culture

Client alignment has been intentionally and thoughtfully embedded into how we operate from the day we were founded and forms the cornerstone of our aligned boutique model. In addition to ensuring alignment with our clients, our model also clarifies the principles on which all our investment teams and employees are focused. We believe these principles are foundational to who we are and how we serve clients, lead to excellent long-term investment results across multiple capabilities and promote enduring client relationships.

- We believe we can add the most value with an **active, fundamentally driven process**.
- We emphasize an **ownership mindset**. Our investment professionals approach each investment as long-term owners. Further, our portfolio managers invest heavily alongside our clients. Every employee owns shares in our company from their first day and has the opportunity to build further ownership in our company and invest in our strategies along with our clients, promoting an ownership mentality throughout the firm.
- We are **long-term oriented**. We believe in the rigor of our research and the power of time-horizon arbitrage. As bottom-up, benchmark-agnostic investors, we expect to outperform over the long term. We are comfortable with shorter periods where our portfolios' performance may meaningfully differ from peers or our clients' benchmarks.

- We invest with a **valuation discipline**, which goes beyond investing according to common industry definitions of growth versus value. Instead, we believe in taking an ownership stake in an investment at a discount to what we believe it is worth and waiting patiently for value to be realized.
- We are committed to **capacity discipline**. We believe prudent capacity management puts our clients' interests first.

Our capacity discipline is a differentiating feature of our firm. Our focus on long-term performance rather than asset growth incentivizes our portfolio managers to prioritize existing clients and close strategies before they reach a size that could limit their ability to deliver value-added returns.

Our Shared Values

We believe we have the right business model and shared investment principles to add value for clients. As important is having a common sense of purpose and direction for all associates. Our culture allows us to attract and retain associates who share our commitment to client alignment, are motivated by investment excellence and are committed to delivering superior outcomes. In short, our culture emphasizes four key values: curiosity, ownership, trust and respect.

Associates who are **curious** focus on continuous self-improvement and have a passion for learning. They are open-minded, seek differing perspectives and go beyond surface-level assumptions. Associates who think and act like business **owners** naturally embrace a long-term mindset. They lead by example and accept accountability for ensuring excellent client outcomes. Associates who embrace **trust** act with integrity, are authentic and honest in interactions with others, and put client interests ahead of all others. Associates who are motivated by giving and receiving **respect** communicate and provide feedback candidly, transparently and with positive intent. They are humble in their assumptions and listen to better understand others. They embrace, value and celebrate diversity, inclusion and differences in all forms.

Taking Action on Diversity, Equity and Inclusion (DEI)

Once we embrace a long-term, valuation-disciplined, client-centric mindset, our success as investors depends on a culture where associates can think differently and feel empowered to challenge conventional wisdom. We believe this creates an environment where intellectually curious professionals—those who are committed to the differentiated thinking necessary to deliver excellent client outcomes—want to come and stay. At the same time, we recognize that our firm and the asset management industry overall have work to do to ensure we create more diverse, equitable and inclusive workplaces. We are committed to providing our clients with better results that come from a diverse talent pool, promoting a more inclusive workplace for our associates and promoting positive change in our industry and community.

As part of our efforts, in June 2020, we explicitly pledged to be more proactive in advancing DEI. To ensure our pledge resulted in action, we organized our efforts under four pillars.

1. **Philanthropy and Community.** We pledged to invest \$1 million over the next five years in organizations that support anti-racism and DEI efforts.

2. **Vendor Relationships and Policies.** We committed to conducting a full review of our vendor relationships with the aim of increasing diversity. We also committed to continually reviewing our policies and procedures to ensure we are supporting diversity and inclusion at our firm.
3. **Workforce Diversity.** We are working on providing internship and employment opportunities to historically underrepresented groups and ensuring a diverse talent pipeline is considered for every open role.
4. **Inclusive Culture.** We know an inclusive culture is imperative to support diversity in an organization. We aim to foster inclusion at Diamond Hill and communicate openly with associates on our DEI progress and efforts. We established a DEI Resource Group that aids in strategizing, planning and executing on our initiatives.

We are proud to have more than 30% of our workforce involved in our DEI efforts, with representation from all teams at the firm. We believe with commitment and focus, our efforts will yield material improvements for our clients, our associates, our shareholders and our community.

Enabling Great Investment Results and Client-Centric Growth

As we plan for meeting current and future client needs, we have undertaken several initiatives. We have begun taking steps to close our Large Cap strategy to most new investors, and we are fostering growth in existing capabilities that are hitting key milestones important to clients. We are also focused on the expansion of a more concentrated suite of strategies that meet client objectives, capitalize on our investment team's research capabilities, build on our success of managing high-conviction portfolios and align with our investment principles.

Managing capacity is core to who we are as a firm and the alignment we seek with clients. As such, we recently announced the closing of our Large Cap strategy to most new investors to ensure asset size does not become an impediment to performance. Capacity management is often viewed as a growth inhibitor in our industry. We view it as part of our promise to clients to always act in their best interests. Further, as an aligned boutique, our growth is not dependent on building excessive AUM in any one strategy, which is why we remain focused on fostering multiple capabilities that leverage our competitive strengths.

Among our existing strategies, we have several reaching five-year milestones in 2021 that have shown the ability to exceed client expectations since inception. These include Core Bond and Short Duration Securitized Bond under the management of portfolio managers Mark Jackson, CFA, and Henry Song, CFA. These portfolios distinguish themselves in the marketplace with a focus on securitized assets, which gives them a differentiated risk/return profile relative to peers. Our International strategy also turns five years old this year, at a time when investor interest in non-U.S. markets is increasing following a long period of U.S. outperformance. In addition to our U.S. equity strategies, we believe these three strategies have tremendous potential in asset classes where investors value active management.

As clients look to their active managers to generate meaningful alpha, they are increasingly demanding high conviction, more concentrated portfolios. Our shared investment principles have always led us to build portfolios that are more highly concentrated than most of our peers. We plan to leverage that expertise by focusing on expanding a suite of more highly concentrated, high-alpha strategies to deliver excellent outcomes and fulfill client needs. Our Large Cap Concentrated strategy is approaching its 10-year anniversary this year, and we plan to

launch it as a new fund in our Diamond Hill Funds lineup. Our Large Cap Concentrated strategy typically has 20 holdings with market capitalizations of greater than \$15 billion, differentiating it from our Large Cap portfolio, which can hold 40-60 positions with market capitalizations of \$5 billion or greater. We have also been running a more highly concentrated portfolio in our All Cap Select strategy. Further, we are planning to offer a Micro Cap strategy that will leverage our experience evaluating companies down the market-cap spectrum.

Our aligned boutique model provides a focus on investment excellence while enabling growth when beneficial to clients. It also fosters an environment for our investment professionals that supports innovative thinking and new ideas. Finally, we believe this model will allow us to keep pace with an industry that is under constant evolution amid pressure to deliver demonstrable value to clients.

Management Update

To execute on our aligned boutique business model, it is critically important to have the right infrastructure and dedicated leadership in place to give our portfolio managers the freedom to focus on generating excellent results. Our management team, which is accountable for our vision, includes me as CEO, our Chief People Officer Anna Corona, General Counsel and Corporate Secretary Carlotta King, Chief Financial Officer Tom Line, Chief Client Officer Jo Ann Quinif and our dedicated Chief Investment Officer (CIO) Matthew Stadelman, CFA, who has absorbed responsibilities previously held by Austin Hawley. Together, we serve as Diamond Hill's primary decision-making body, responsible for overall business strategy and corporate capital allocation.

We created the Chief Client Officer role in 2020 to ensure we remain focused on delivering a great client experience overall. Jo Ann was a natural fit for the role given her leadership and responsibilities as our managing director of business development and marketing. We also created the Chief People Officer role to emphasize the importance of attracting, retaining and developing talented associates with a passion for client alignment while cultivating our core values. We were fortunate to identify Anna for this role, who came to us from Morningstar Australasia with broad experience in talent development, succession planning, coaching and benefits. We were also delighted to add Carlotta to the firm in 2020 as general counsel—she brings extensive financial industry and legal expertise to this vital role, where she will focus on the relationship between our corporate board of directors and the management team as part of her responsibilities.

The dedicated CIO role marks an important transition for Diamond Hill, giving Austin greater focus on portfolio management responsibilities. As someone who is steeped in Diamond Hill's investment philosophy, process, culture and values, Matthew was the ideal candidate for this role. He will act as an external voice of the investment team with clients, advocate for our investment team internally, and play a key role in hiring and feedback. He will closely collaborate with portfolio managers but will not have any portfolio decision-making responsibilities, allowing portfolio managers the continued freedom and autonomy to execute their philosophy. The trading team will also report to Matthew, enabling Chris Welch to further focus on portfolio management responsibilities. We are deeply appreciative of Austin and Chris for their dedication and leadership and are pleased to give them the freedom to focus on generating returns for clients.

We appointed Micah Martin, CFA, as our Director of Research to provide dedicated leadership to our U.S. research team. This structure enables more mentoring and professional development opportunities for our research team. With our portfolio managers freed from operational responsibilities, there are also more opportunities for

collaboration within our deep investment team. We are confident the changes made to our management infrastructure have positioned Diamond Hill to thrive for the long term.

Financial Results

Diamond Hill is starting 2021 in a much stronger position than 2020. Assets under management finished the year at \$26.4 billion compared with \$23.4 billion at the start of the year. Importantly, the \$3.0 billion in growth came from both net client inflows of \$1.5 billion and market appreciation of a similar amount. We saw positive client flows in our Large Cap and Mid Cap strategies as well as in each of our four fixed income strategies. These positive flows were partially offset by outflows in our Long-Short, Small Cap and Small-Mid Cap strategies. Revenue declined 7% to \$126.4 million in 2020. While we grew assets 13% during the year, our average assets under management were approximately the same as 2019 due to the severe market downturn in the first half of the year in response to the pandemic. Our average advisory fee rate declined from 0.59% to 0.54% due to the shift in asset mix to lower fee strategies.

We generated net operating income of \$45.5 million in 2020, a decrease of 5% from 2019, and our operating margin increased from 35% in 2019 to 36% in 2020. We focus on net operating income as adjusted, after tax, which excludes the gains and losses on deferred compensation plan investments that flow through operating income. Net operating income, as adjusted, after tax, was \$35.1 million in 2020 compared with \$40.2 million in 2019. This equates to \$10.91 per share in 2020 compared with \$11.71 per share in 2019. Our operating profit margin, as adjusted, was 38% in 2020 compared with 39% in 2019.

As stewards of our business, our goal is to grow the long-term intrinsic value of our firm. Over the last five years, important fundamental indicators of Diamond Hill's intrinsic value per share have increased. Assets under management increased more than 50%, and tangible book value per share almost doubled, from \$30.84 in 2015 to \$58.09 in 2020. Net operating income, as adjusted, after tax, per share has remained relatively flat at \$10.91 in 2020 compared to \$11.17 in 2015. Shareholders have derived significant value from the company's cash flows and tangible net assets, receiving special dividends in each of the past five years cumulatively totaling \$42.00 per share. While we expect the share price to converge with the value of the business over time, when the share price deviates significantly from intrinsic value over shorter periods, it does not change our long-term focus. When our share price is trading significantly below our estimate of intrinsic value, we may take the opportunity to buy back shares.

In February 2021, we announced that we entered into a definitive agreement to enable Brandywine Global Investment Management to acquire the business of Diamond Hill's high yield-focused mutual funds—the High Yield and Corporate Credit Funds. The transaction is expected to close in the third quarter of 2021, subject to customary closing conditions, including fund shareholder approval. In connection with the transaction, two portfolio managers and a research associate will join Brandywine Global's credit team. At closing, Diamond Hill will receive an initial cash payment of up to \$9.0 million, and may receive additional payments totaling up to \$13.0 million based on the net revenue of the acquired funds on the one-year anniversary of the closing date.

Capital Allocation

Our approach to capital allocation is designed to grow the intrinsic value of the business by investing in new and existing strategies and ensuring we have sufficient cash to run the business in any market environment. When we

believe we have more capital than is necessary to achieve those aims, we will continue to return capital to shareholders.

Beginning in the fourth quarter of 2018, we implemented a share repurchase plan. Since that time, we have repurchased approximately 480,000 shares totaling \$65 million, which represents 13.6% of our shares outstanding when the plan started. We have \$35 million remaining in our current share repurchase plan, and we intend to continue to repurchase our shares when they trade at a meaningful discount to our estimate of the firm's intrinsic value.

After considering strategic uses of capital for seeding our strategies and share repurchases, we then evaluate any excess capital when considering dividends to be paid to our shareholders. Our \$12.00 per share dividend in 2020 marked the 13th consecutive year that we paid a special dividend.

Given our history of consistently generating excess cash flow, in October we announced plans to institute a regular quarterly dividend of \$1.00 per share starting in the first quarter of 2021. In addition, each year we will consider paying an additional special dividend.

Conclusion

When I joined Diamond Hill in September 2019, the last thing I expected was to be navigating our business through the first (and hopefully only) global pandemic of our lifetimes. The loss we have seen across the world is devastating. The long-term consequences of the pandemic are far-reaching and may never be fully understood. My heart goes out to all those who have lost loved ones and friends.

These events have helped me realize how proud I am to be part of the Diamond Hill team. Our associates handled the extreme disruption and loss of the last year with compassion and professionalism and, despite personal challenges, always put our clients' interests first. I have also been impressed by our team's ability to remain focused on the long term—ensuring we are making sound investment decisions and have the right infrastructure in place to keep meeting client needs far into the future.

Diamond Hill is emerging from the challenges of the last year with fresh perspectives. Some things have not changed—most importantly our commitment to excellent outcomes that help improve clients' lives. In other ways, we are proud to have changed, and we are emerging as a more nimble, focused and innovative business, ready to evolve as the industry and our clients require. I am excited and energized about the future we face, and look forward to working with our fantastic team of associates to deliver for our clients. I am grateful for the partnership of our associates, clients and shareholders that enables us to deliver on our vision.

Sincerely,

A handwritten signature in black ink, appearing to read "Heather Brilliant", with a stylized flourish at the end.

Heather Brilliant
Chief Executive Officer

ANNEX - RECONCILIATION OF NON-GAAP MEASURES

As supplemental information, we are providing performance measures that are based on methodologies other than U.S. generally accepted accounting principles (“non-GAAP”). We believe the non-GAAP measures below are useful measures of our core business activities, are important metrics in estimating the value of an asset management business and may enable more appropriate comparison to our peers. These non-GAAP measures should not be a substitute for financial measures calculated in accordance with U.S. generally accepted accounting principles (“GAAP”) and may be calculated differently by other companies. The following schedule reconciles GAAP measures to non-GAAP measures for the years ended December 31, 2020, 2019, 2018, 2017, 2016 and 2015 respectively.

(in thousands, except percentages and per share data)	Year Ended December 31,					
	2020	2019	2018	2017	2016	2015
Total revenue	\$ 126,388	\$ 136,624	\$ 145,628	\$ 145,202	\$ 136,103	\$ 124,426
Net operating income, GAAP basis	\$ 45,538	\$ 47,935	\$ 71,256	\$ 67,001	\$ 63,069	\$ 58,720
Non-GAAP adjustments:						
Gains (losses) on deferred compensation plan investments, net ⁽¹⁾	2,219	5,977	(2,122)	2,382	1,837	(234)
Net operating income, as adjusted, non-GAAP basis ⁽²⁾	47,757	53,912	69,134	69,383	64,906	58,486
Non-GAAP adjustments:						
Tax provision on net operating income, as adjusted, non-GAAP basis ⁽³⁾	(12,668)	(13,680)	(19,542)	(25,704)	(23,626)	(21,090)
Net operating income, as adjusted, after tax, non-GAAP basis ⁽⁴⁾	\$ 35,089	\$ 40,232	\$ 49,592	\$ 43,679	\$ 41,280	\$ 37,396
Net operating income, as adjusted after tax per diluted share, non-GAAP basis ⁽⁵⁾	\$ 10.91	\$ 11.71	\$ 14.11	\$ 12.65	\$ 12.09	\$ 11.13
Diluted weighted average shares outstanding, GAAP basis	3,215	3,437	3,515	3,452	3,413	3,360
Operating profit margin, GAAP basis	36 %	35 %	49 %	46 %	46 %	47 %
Operating profit margin, as adjusted, non-GAAP basis ⁽⁶⁾	38 %	39 %	47 %	48 %	48 %	47 %

⁽¹⁾ *Gains (losses) on deferred compensation plan investments, net:* The gain (loss) on deferred compensation plan investments, which increases (decreases) deferred compensation expense included in operating income, is removed from operating income in the calculation because it is offset by an equal amount in investment income (loss) below net operating income on the income statement, and thus has no impact on net income attributable to us.

⁽²⁾ *Net operating income, as adjusted:* This non-GAAP measure represents our net operating income adjusted to exclude the impact on compensation expense of gains and losses on investments in the deferred compensation plan.

⁽³⁾ *Tax provision on net operating income, as adjusted:* This non-GAAP measure represents the tax provision excluding the impact of investment related activity and the sale of subsidiary and is calculated by applying the unconsolidated effective tax rate to net operating income, as adjusted.

⁽⁴⁾ *Net operating income, as adjusted, after tax:* This non-GAAP measure deducts from the net operating income, as adjusted, the tax provision on net operating income, as adjusted.

⁽⁵⁾ *Net operating income, as adjusted after tax per diluted share:* This non-GAAP measure was calculated by dividing the net operating income, as adjusted after tax, by diluted weighted average shares outstanding.

⁽⁶⁾ *Operating profit margin, as adjusted:* This non-GAAP measure was calculated by dividing the net operating income, as adjusted, by total revenue.