Pzena Investment Management, Inc.
Form 10-Q
May 07, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the Quarterly Period Ended March 31, 2010

Or

o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from to

Commission file number 001-33761

PZENA INVESTMENT MANAGEMENT, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**20-8999751**

(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

120 West 45th Street

New York, New York 10036

(Address of Principal Executive Offices) (Zip Code)

Registrant s telephone number, including area code: **(212) 355-1600**

Not Applicable
(Former name, former address, and former fiscal year if changed since last report)

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Date File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of May 7, 2010, there were 9,367,659 outstanding shares of the registrant s Class A common stock, par value $0.01 per share.

As of May 7, 2010, there were 54,960,918 outstanding shares of the registrant s Class B common stock, par value $0.000001 per share.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements. Forward-looking statements provide our current expectations, or forecasts, of future events. Forward-looking statements include statements about our expectations, beliefs, plans, objectives, intentions, assumptions, and other statements that are not historical facts. Words or phrases such as anticipate, believe, continue, ongoing, estimate, e intend, may, plan, potential, predict, project, or similar words or phrases, or the negatives of those words or phrases, may identify forward-looking statements, but the absence of these words does not necessarily mean that a statement is not forward-looking.

Forward-looking statements are subject to known and unknown risks and uncertainties and are based on potentially inaccurate assumptions that could cause actual results to differ materially from those expected or implied by the forward-looking statements. Our actual results could differ materially from those anticipated in forward-looking statements for many reasons, including the factors described in Item 1A, Risk Factors in Part I of our Annual Report on Form 10-K for our fiscal year ended December 31, 2009. Accordingly, you should not unduly rely on these forward-looking statements, which speak only as of the date of this Quarterly Report. We undertake no obligation to publicly revise any forward-looking statements to reflect circumstances or events after the date of this Quarterly Report, or to reflect the occurrence of unanticipated events. You should, however, review the factors and risks we describe in the reports we will file from time to time with the Securities and Exchange Commission, or SEC, after the date of this Quarterly Report on Form 10-Q.

Forward-looking statements include, but are not limited to, statements about:

- our anticipated future results of operations and operating cash flows;
- our business strategies and investment policies;
- our financing plans and the availability of short- or long-term borrowing, or equity financing;
- our competitive position and the effects of competition on our business;
- potential growth opportunities available to us;
- the recruitment and retention of our employees;
- our expected levels of compensation for our employees;

- our potential operating performance, achievements, efficiency, and cost reduction efforts;
- our expected tax rate;
- changes in interest rates;
- our expectation with respect to the economy, capital markets, the market for asset management services, and other industry trends; and
- the impact of future legislation and regulation, and changes in existing legislation and regulation, on our business.

The reports that we file with the SEC, accessible on the SEC s website at *www.sec.gov*, identify additional factors that can affect forward-looking statements.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

PZENA INVESTMENT MANAGEMENT, INC.

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(in thousands, except share and per-share amounts)

	As of			
	March 31, 2010 (unaudited)		**December 31, 2009**	
ASSETS				
Cash and Cash Equivalents	$	19,661	$	15,908
Restricted Cash		1,411		1,407
Due from Broker		16		116
Advisory Fees Receivable		13,454		13,378
Investments in Equity Securities, at Fair Value		8,701		7,951
Receivable from Related Parties		67		149
Other Receivables		96		36
Prepaid Expenses and Other Assets		619		504
Deferred Tax Asset, Net of Valuation Allowance of $62,172 and $60,252, respectively		7,858		6,754
Property and Equipment, Net of Accumulated Depreciation of $2,492 and $2,385, respectively		2,214		2,315
TOTAL ASSETS	$	54,097	$	48,518
LIABILITIES AND EQUITY				
Liabilities:				
Accounts Payable and Accrued Expenses	$	5,265	$	3,644
Due to Broker		7		731
Senior Subordinated Notes		7,500		10,000
Liability to Selling and Converting Shareholders		7,001		5,642
Other Liabilities		949		1,143
TOTAL LIABILITIES		20,722		21,160
Equity:				
Preferred Stock (Par Value $0.01; 200,000,000 Shares Authorized; None Outstanding)				
Class A Common Stock (Par Value $0.01; 750,000,000 Shares Authorized; 9,367,659 and 8,633,041 Shares Issued and Outstanding in 2010 and 2009, respectively)		93		86
Class B Common Stock (Par Value $0.000001; 750,000,000 Shares Authorized; 54,931,418 and 55,659,236 Shares Issued and Outstanding in 2010 and 2009, respectively)				
Additional Paid-In Capital		10,559		10,104
Accumulated Deficit		(936)		(1,920)
Total Pzena Investment Management, Inc. s Equity		9,716		8,270
Non-Controlling Interests		23,659		19,088
TOTAL EQUITY		33,375		27,358

TOTAL LIABILITIES AND EQUITY	$	54,097	$	48,518

See accompanying notes to consolidated financial statements

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PZENA INVESTMENT MANAGEMENT, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per-share amounts)

	For the Three Months Ended March 31, 2010	2009
REVENUE	$ 19,150	$ 13,671
EXPENSES		
Compensation and Benefits Expense	7,388	6,040
General and Administrative Expenses	1,921	2,453
TOTAL OPERATING EXPENSES	9,309	8,493
Operating Income	9,841	5,178
OTHER INCOME/(EXPENSE)		
Interest and Dividend Income	73	120
Interest Expense	(155)	(450)
Realized and Unrealized Gain/(Loss), Net on Equity Securities	464	(1,820)
Other Expense	(1,047)	(580)
Total Other Expense	(665)	(2,730)
Income Before Income Taxes	9,176	2,448
Income Tax Benefit	(99)	(274)
Consolidated Net Income	9,275	2,722
Less: Net Income Attributable to Non-Controlling Interests	8,291	2,240
Net Income Attributable to Pzena Investment Management, Inc.	$ 984	$ 482
Earnings per Share - Basic and Diluted Attributable to Pzena Investment Management, Inc. Common Stockholders:		
Net Income for Basic Earnings per Share	$ 984	$ 482
Basic Earnings per Share	$ 0.11	$ 0.07
Basic Weighted Average Shares Outstanding	8,633,041	6,948,037
Net Income for Diluted Earnings per Share	$ 5,722	$ 2,776
Diluted Earnings per Share	$ 0.09	$ 0.04
Diluted Weighted Average Shares Outstanding	65,005,989	64,192,792

See accompanying notes to consolidated financial statements

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PZENA INVESTMENT MANAGEMENT, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	For the Three Months Ended March 31, 2010	2009
OPERATING ACTIVITIES		
Consolidated Net Income	$ 9,275	$ 2,722
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities		
Cash Provided by Operating Activities:		
Depreciation	107	121
Non-Cash Compensation	842	251
Director Share Grant	13	280
Realized and Unrealized (Gain)/Loss, Net on Equity Securities	(464)	1,820
Increase in Liability to Selling and Converting Shareholders	1,026	602
Deferred Income Taxes	(771)	(667)
Changes in Operating Assets and Liabilities:		
Advisory Fees Receivable	(76)	3,290
Due from Broker	100	4
Restricted Cash	(4)	
Prepaid Expenses and Other Assets	(133)	(147)
Due to Broker	(724)	(6)
Accounts Payable, Accrued Expenses, and Other Liabilities	1,293	727
Purchases of Equity Securities	(1,153)	(2,572)
Proceeds from Sale of Equity Securities	866	3,431
Net Cash Provided by Operating Activities	**10,197**	**9,856**
INVESTING ACTIVITIES		
Receivable from Related Parties	40	2
Purchases of Property and Equipment	(7)	
Net Cash Provided by Investing Activities	**33**	**2**
FINANCING ACTIVITIES		
Distributions to Non-Controlling Interests	(3,976)	(2,574)
Retirement of B Units	(2)	
Term Loan and Senior Subordinated Notes Repayment	(2,500)	(8,000)
Net Cash Used in Financing Activities	**(6,478)**	**(10,574)**
NET CHANGE IN CASH	**$ 3,752**	**$ (716)**
CASH AND CASH EQUIVALENTS - Beginning of Period	$ 15,908	$ 27,421
Net Change in Cash	3,752	(716)
CASH AND CASH EQUIVALENTS - End of Period	$ 19,660	$ 26,705
Supplementary Cash Flow Information:		
Interest Paid	$ 155	$ 467
Income Taxes Paid	$ 823	$ 619

See accompanying notes to consolidated financial statements

PZENA INVESTMENT MANAGEMENT, INC.

UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(in thousands, except share amounts)

	Shares of Class A Common Stock	Shares of Class B Common Stock	Class A Common Stock	Additional Paid-In Capital	(Accumulated Deficit)	Non-Controlling Interests	Total
Balance at December 31, 2009	**8,633,041**	**55,659,236**	**$ 86**	**$ 10,104**	**$ (1,920)**	**$ 19,088**	**$ 27,358**
Unit Conversion	734,618	(734,618)	7	368		(318)	**57**
Retirement of Class B Units		(700)				(2)	**(2)**
Directors Shares						13	**13**
Amortization of Non-Cash Compensation		7,500		87		563	**650**
Net Income					984	8,291	**9,275**
Capital Distribution						(3,976)	**(3,976)**
Balance at March 31, 2010	**9,367,659**	**54,931,418**	**$ 93**	**$ 10,559**	**$ (936)**	**$ 23,659**	**$ 33,375**

See accompanying notes to consolidated financial statements

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Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements

Note 1 Organization

Pzena Investment Management, Inc. (the Company) functions as the holding company through which the business of its operating company, Pzena Investment Management, LLC, is conducted. The Company was incorporated in the State of Delaware on May 8, 2007. On October 30, 2007, the Company consummated an initial public offering. Concurrently with the consummation of the Company s initial public offering, the operating agreement of Pzena Investment Management, LLC (the operating agreement) was amended and restated such that, among other things, the Company became the sole managing member of Pzena Investment Management, LLC. The acquisition of the operating company s membership interests by the Company was treated as a reorganization of entities under common control. As a result of these transactions, as of and subsequent to October 30, 2007, (i) the Company has consolidated the financial results of Pzena Investment Management, LLC with its own and reflected the membership interest in it that it does not own as a non-controlling interest in its consolidated financial statements, and (ii) the Company recognizes income generated from its economic interest in Pzena Investment Management, LLC s net income.

Pzena Investment Management, LLC is an investment adviser which is registered under the Investment Advisers Act of 1940 and is headquartered in New York, New York. As of March 31, 2010, the Company managed assets in a variety of value-oriented investment strategies across a wide range of market capitalizations in both U.S. and non-U.S. capital markets.

The Company, through its investment in its operating company, has consolidated the results of operations and financial condition of the following private investment partnerships as of March 31, 2010:

Entity	Type of Entity (Date of Formation)	Ownership at March 31, 2010
Pzena Large Cap Value Fund	Massachusetts Trust (11/01/2002)	99.9%
Pzena Emerging Markets Country Value Service	Delaware Limited Liability Company (12/28/2007)	99.9%
Pzena Emerging Markets Focused Value Service	Delaware Limited Liability Company (12/28/2007)	99.9%

Note 2 Significant Accounting Policies

Basis of Presentation:

The consolidated financial statements are prepared in conformity with U.S. generally accepted accounting principles (GAAP) and related Securities and Exchange Commission (SEC) rules and regulations. The Company s policy is to consolidate all majority-owned subsidiaries in which it has a controlling financial interest and variable-interest entities where the Company is deemed to be the primary beneficiary (consolidated subsidiaries). As required by the *Consolidation Topic* of the Financial Accounting Standards Board Accounting Standards Codification (FASB ASC), the Company also consolidates non-variable-interest entities in which it acts as the general partner or managing member. All of these entities represent private investment partnerships over which the Company exercises or exercised control. Non-controlling interests recorded on the consolidated financial statements of the Company include the non-controlling interests of the outside investors in each of these entities, as well as those of the operating company. All significant inter-company transactions and balances have been eliminated.

The Pzena Global Value Service and the Pzena Europe, Australasia, and Far East (EAFE) Value Service (formerly known as the International Value Service) are limited liability companies whose managing members are or were members of the executive committee of the operating company, or the operating company itself. Until December 31, 2009, neither of these entities were considered variable-interest entities, as the members of the executive committee of the operating company and/or the operating company had substantive interests in the partnerships. Each of these limited liability companies were considered entities similar to limited partnerships, and are subject to the guidance of the *Consolidation Topic* of the FASB ASC. Under each of their respective operating agreements, none of these entities non-managing members have the ability to remove the managing member under any circumstance, nor do they have any participating rights. As a result, nothing substantive existed to overcome the presumption of control by the managing member, as required by the *Consolidation Topic* of the FASB ASC. Since the managing members of these entities were either the operating company, or one of the controlling persons of the operating company, their results of operations and financial position had been consolidated through December 30, 2009.

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Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (continued)

Effective December 31, 2009, substantially all of the Company s investments in the Pzena Global Value Service and the Pzena EAFE Value Service, held to satisfy the Company s obligations under its deferred compensation program, were reallocated to the Pzena Large Cap Value Fund. Also effective December 31, 2009, the investments of the operating company s executive committee members in the Pzena Global Value Service and the Pzena EAFE Value Service were transferred to a separately-managed account. As neither the Company nor the members of the operating company s executive committee had substantive interests in the partnerships subsequent to the removal of these investments, as of December 31, 2009, these entities were deemed variable-interest entities. The Company is not considered the primary beneficiary of these entities. Correspondingly, the Pzena Global Value Service and the Pzena EAFE Value Service were deconsolidated effective December 31, 2009. The results of operations and financial position of each of these entities were consolidated up until December 30, 2009.

All of the consolidated investment partnerships are, or were, investment companies under the American Institute of Certified Public Accountants Audit and Accounting Guide for Investment Companies. The Company has retained the specialized accounting for these partnerships pursuant to the *Consolidation Topic* of the FASB ASC. Thus, the Company reports the investment partnerships investments in equity securities at fair value, with net realized and unrealized gains and losses reported in earnings in the consolidated statements of operations.

The Company records in its own equity its pro-rata share of transactions that impact the operating company s net equity, including equity and option issuances and adjustments to accumulated other comprehensive income. The operating company s pro-rata share of such transactions are recorded as adjustments to additional paid-in capital or non-controlling interests, as applicable, on the consolidated statements of financial position.

The Company acts as the investment manager for several variable-interest entities. All of these entities are vehicles through which the Company offers its Global Value and/or its EAFE Value Strategies. The Company is not considered the primary beneficiary of any of these entities. Correspondingly, their results of operations and financial condition are not consolidated by the Company. The total net assets of these variable-interest entities was approximately $547.5 million and $522.1 million at March 31, 2010 and December 31, 2009, respectively. The Company is not exposed to losses as a result of its involvement with these entities because it has no direct investment in them.

Management s Use of Estimates:

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the period. Actual results could differ from those estimates.

Fair Values of Financial Instruments:

The carrying amounts of all financial instruments in the consolidated statements of financial condition, including investments in equity securities, approximate their fair value.

Revenue Recognition:

Revenue, comprised of advisory fee income, is recognized over the period in which advisory services are provided. Advisory fee income includes management fees that are calculated based on percentages of assets under management (AUM), generally billed quarterly, either in arrears or advance, depending on their contractual terms. Advisory fee income also includes incentive fees that may be earned by the Company depending on the investment return of the AUM. Incentive fee arrangements generally entitle the Company to participate, on a fixed-percentage basis, in any returns generated in excess of an agreed-upon benchmark. The Company s participation percentage in such return differentials is then multiplied by AUM to determine the incentive fees earned. In general, returns are calculated on an annualized basis over the contract s measurement period, which usually extends up to three years. Incentive fees are generally payable annually. Following the preferred method identified in the *Revenue Recognition Topic* of the FASB ASC, such incentive fee income is recorded at the conclusion of the contractual performance period, when all contingencies are resolved.

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Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (continued)

Earnings per Share:

Basic earnings per share is computed by dividing the Company s net income or loss attributable to the Company s common stockholders by the weighted average number of shares outstanding during the reporting period. Diluted earnings per share adjusts this calculation to reflect the impact of all outstanding operating company Class B units, outstanding operating company phantom Class B units, and outstanding options granted under the Pzena Investment Management, LLC 2006 Equity Incentive Plan (the 2006 Plan) and the Pzena Investment Management, Inc. 2007 Equity Incentive Plan (the 2007 Plan), to the extent they would have a dilutive effect on net income per share for the reporting period. Net income for diluted earnings per share generally assumes all operating company Class B units are converted into Company stock at the beginning of the reporting period and the resulting change to Company net income associated with its increased interest in the operating company is taxed at the Company s effective tax rate.

For the three months ended March 31, 2010 and 2009, the Company s diluted net income was determined as follows:

	For the Three Months Ended March 31, 2010		2009	
	(in thousands)			
Non-Controlling Interests of Pzena Investment Management, LLC	$	8,291	$	3,566
Less: Assumed Corporate Income Taxes		3,553		1,272
Assumed After-Tax Income of Pzena Investment Management, LLC	$	4,738	$	2,294
Assumed After-Tax Income of Pzena Investment Management, LLC	$	4,738	$	2,294
Net Income of Pzena Investment Management, Inc.		984		482
Diluted Net Income	$	5,722	$	2,776

For the three months ended March 31, 2010, 1,620,060 options to purchase operating company units, 961,750 options to purchase Class A common stock, and 84,916 phantom operating company units were excluded from the calculation of diluted net income per share, as their inclusion would have had an antidilutive effect for the period. For the three months ended March 31, 2009, 3,153,122 options to purchase operating company units, and 153,829 phantom operating company units were excluded from the calculation of diluted net income per share, as their inclusion would have had a similarly antidilutive effect for the period.

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Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (continued)

For the three months ended March 31, 2010 and 2009, the Company s basic and diluted earnings per share were determined as follows:

	For the Three Months Ended March 31, 2010 (in thousands, except share and per-share amounts)	For the Three Months Ended March 31, 2009 (in thousands, except share and per-share amounts)
Net Income for Basic Earnings per Share	$ 984	$ 482
Basic Weighted Average Shares Outstanding	8,633,041	6,948,037
Basic Earnings per Share	$ 0.11	$ 0.07
Net Income for Diluted Earnings per Share	$ 5,722	$ 2,776
Dilutive Effect of Operating Company Class B Units	55,696,236	57,244,755
Dilutive Effect of Phantom Units	17,022	
Dilutive Effect of Options	659,690	
Diluted Weighted Average Shares Outstanding	65,005,989	64,192,792
Diluted Earnings per Share	$ 0.09	$ 0.04

Cash and Cash Equivalents:

At March 31, 2010, cash and cash equivalents was $19.7 million, inclusive of $0.2 million held by the Company s consolidated subsidiaries. The Company considers all highly-liquid debt instruments with an original maturity of three months or less at the time of purchase to be cash equivalents. The Company maintains its cash in bank deposit and other accounts whose balances, at times, exceed federally insured limits.

Interest on cash and cash equivalents is recorded as interest income on an accrual basis on the consolidated statements of operations.

Restricted Cash:

The Company maintains a compensating balance of $1.4 million at March 31, 2010 as collateral for a letter of credit issued by a third party in lieu of a cash security deposit, as required by the Company s lease for its New York office space. Such amounts are recorded in restricted cash on the consolidated statements of financial condition.

Due to/from Broker:

Due to/from broker consists primarily of cash balances and amounts receivable/payable for unsettled securities transactions held/initiated at the clearing brokers of the Company s consolidated investment partnerships.

Investments in Securities:

Investments in equity securities represent the securities held by the Company and its consolidated investment partnerships. All such securities are recorded at fair value, with net realized and unrealized gains and losses reported in earnings in the consolidated statements of operations.

The *Fair Value Measurements and Disclosures Topic* of the FASB ASC defines fair value as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. The *Fair Value Measurements and Disclosures Topic* of the FASB ASC also establishes a framework for measuring fair value and a valuation hierarchy based upon the transparency of inputs used in the valuation of an asset or liability. Classification within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The valuation hierarchy contains three levels: (i) valuation inputs are unadjusted quoted market prices for identical assets or liabilities in active markets (Level 1); (ii) valuation inputs are quoted prices for identical assets or liabilities in markets that are not active, quoted market prices for similar assets and liabilities in active markets, and other observable inputs directly or indirectly related to the asset or liability being measured (Level 2); and (iii) valuation inputs are unobservable and significant to the fair value measurement (Level 3). Additionally, entities are required to disclose in interim and annual periods the inputs and valuation techniques used to measure fair value and define assets and liabilities measured at fair value by major class.

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Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (continued)

The Company s fair value measurements relate to its investments in equity securities, which are primarily exchange-traded securities with quoted prices in active markets. The fair value measurements of the securities have been classified as Level 1.

The following table presents these instruments fair value at March 31, 2010:

	Level 1	Level 2 (in thousands)	Level 3
Assets:			
Equity Securities	$ 8,701	$	$
Total Fair Value	$ 8,701	$	$

The following table presents these instruments fair value at December 31, 2009:

	Level 1	Level 2 (in thousands)	Level 3
Assets:			
Equity Securities	$ 7,951	$	$
Total Fair Value	$ 7,951	$	$

Securities Valuation:

Investments in equity securities which are traded on a national securities exchange are carried at fair value based on the last reported sales price on the valuation date. If no reported sales occurred on the valuation date, investments in securities are valued at the bid price. Securities transactions are recorded on the trade date.

The net realized gain or loss on sales of securities is determined on a specific identification basis and is included in realized and unrealized gain/(loss), net on equity securities in the consolidated statements of operations.

Concentrations of Credit Risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, amounts due from brokers, and advisory fees receivable. The Company maintains its cash and temporary cash investments in bank deposits and other accounts whose balances, at times, exceed federally insured limits.

The concentration of credit risk with respect to advisory fees receivable is generally limited due to the short payment terms extended to clients by the Company. On a periodic basis, the Company evaluates its advisory fees receivable and establishes an allowance for doubtful accounts, if necessary, based on a history of past write-offs and collections and current credit conditions. For the three months ended March 31, 2010 and 2009, approximately 9.6% and 12.2%, respectively, of the Company s advisory fees were generated from an advisory agreement with one client. At March 31, 2010 and December 31, 2009, no allowance for doubtful accounts has been deemed necessary.

Financial Instruments:

On February 28, 2008, the operating company entered into an interest rate swap agreement, as discussed further in Note 9. This interest rate swap was subsequently unwound in conjunction with the termination of the credit agreement in September 2009. The counterparty to this agreement was a major financial institution. The Company s swap agreement was designated as a trading derivative and the fair value was recorded in other liabilities, with changes to the swap s fair value recognized as a component of other income/(expense). For the three months ended March 31, 2009, the Company recognized less than $0.1 million in other income related to such changes.

Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (continued)

Pursuant to the guidance in the *Derivatives and Hedging Topic* of the FASB ASC, it is a requirement to disclose balance sheet and income statement amounts of derivatives, as well as their locations within the financial statements. The following table summarizes the impact of the Company s derivative financial instruments on its results of operations for the three months ended March 31, 2009:

Derivatives Not Accounted For As Hedging Instruments Under the Derivatives and Hedging Topic of the FASB ASC	**Statement of Operations Account**	**Amount of Income Recognized in Income of Derivative (in thousands)**	
Interest Rate Contracts	Other Income	$	25
Total		$	25

Property and Equipment:

Property and equipment is carried at cost, less accumulated depreciation and amortization. Depreciation is provided on a straight-line basis over the estimated useful lives of the respective assets, which range from three to seven years. Leasehold improvements are amortized on a straight-line basis over the shorter of the useful life of the improvements or the remaining lease term.

Business Segments:

The Company views its operations as comprising one operating segment.

Income Taxes:

The Company is a C corporation under the Internal Revenue Code, and thus liable for federal, state, and local taxes on the income derived from its economic interest in its operating company. The operating company is a limited liability company that has elected to be treated as a partnership for tax purposes. It has not made a provision for federal or state income taxes because it is the individual responsibility of each of the operating company s members (including the Company) to separately report their proportionate share of the operating company s taxable income or loss. Similarly, the income of the Company s consolidated investment partnerships is not subject to income taxes, since it is allocated to each partnership s individual partners. The operating company has made a provision for New York City Unincorporated Business Tax (UBT).

The Company and its consolidated subsidiaries account for all federal, state, and local taxation pursuant to the asset and liability method, which requires deferred income tax assets and liabilities to be recorded for temporary differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the periods in which the temporary differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount more likely than not to be realized. At March 31, 2010, the Company had a $62.2 million valuation allowance against the deferred tax asset recorded as part of the Company s initial public offering and the subsequent exchanges of Class B units for shares of its Class A common stock. At December 31, 2009, the Company had a $60.3 million valuation allowance against this deferred tax asset. The income tax provision, or benefit, is the tax payable or refundable for the period, plus or minus the change during the period in deferred tax assets and liabilities. The Company records its deferred tax liabilities as a component of other liabilities on the consolidated statements of financial condition.

Foreign Currency:

Investment securities and other assets and liabilities denominated in foreign currencies are remeasured into U.S. dollar amounts at the date of valuation. Purchases and sales of investment securities, and income and expense items denominated in foreign currencies, are remeasured into U.S. dollar amounts on the respective dates of such transactions.

The Company does not isolate that portion of the results of its operations resulting from changes in foreign exchange rates on investments from the fluctuations arising from changes in market prices of securities held. Such fluctuations are included in the realized and unrealized gain/(loss), net on equity securities in the consolidated statements of operations.

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Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 2 Significant Accounting Policies (continued)

Reported net realized foreign exchange gains or losses arise from sales of foreign currencies, currency gains or losses realized between the trade and settlement dates on securities transactions, and the difference between the amounts of dividends, interest, and foreign withholding taxes recorded on the Company s books and the U.S. dollar equivalent of the amounts actually received or paid. Net realized foreign exchange gains and losses arise from changes in the fair values of assets and liabilities resulting from changes in exchange rates.

Recent Accounting Pronouncements

In June 2009, the FASB issued a new standard that requires an enterprise to perform a qualitative analysis to determine whether its variable-interests give it a controlling financial interest in a variable interest entity (VIE). Under the standard, an enterprise has a controlling financial interest when it has (a) the power to direct the activities of a VIE that most significantly impact the entity s economic performance, and (b) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. An enterprise that holds a controlling financial interest in a VIE is deemed to be the primary beneficiary of the VIE and is required to consolidate the VIE. The standard also requires an ongoing assessment of whether an enterprise is the primary beneficiary of a variable-interest entity, and additional disclosures about an enterprise s involvement in VIEs, and any significant changes in risk exposure due to that involvement. The standard is effective for fiscal years beginning after November 15, 2009. In November 2009, the FASB issued a proposed standard update, which defers the consolidation criteria requirements of this new standard for assets managers interests in entities that apply the specialized accounting guidance for investment companies, or that have the attributes of investment companies. As of the January 27, 2010 FASB meeting, the FASB decided to make official the deferral of this standard for certain investment entities. The Company has evaluated its interests in entities and determined that the standard is applicable for the Company s investment in its operating company, but that the Company meets the criteria for deferral provided in this standard for its consolidated funds. The Company adopted the updated guidance on January 1, 2010, and it had no impact on the Company s consolidated financial statements.The Company is monitoring for future guidance updates for its interests in its consolidated subsidiaries.

In January 2010, the FASB issued Accounting Standards Update No. 2010-06 (ASU 2010-06), which amends the use of fair value measures and the related disclosures. ASU 2010-06 requires new disclosures for transfers in and out of Level 1 and Level 2 fair value measurements. The Company adopted ASU 2010-06 during the three months ended March 31, 2010, and its adoption had no significant impact on the Company s consolidated financial statements.

Note 3 Property and Equipment

Property and equipment, net, is comprised of the following:

	As of March 31, 2010	As of December 31, 2009
	(in thousands)	
Leasehold Improvements	$ 2,145	$ 2,145
Furniture and Fixtures	1,162	1,163
Computer Hardware	944	948
Office Equipment	243	243
Computer Software	212	201
Total	4,706	4,700
Less: Accumulated Depreciation and Amortization	(2,492)	(2,385)
Total	$ 2,214	$ 2,315

Depreciation is included in general and administrative expenses and totaled $0.1 million for each of the three months ended March 31, 2010 and 2009.

Note 4 Related Party Transactions

For the three months ended March 31, 2010 and 2009, the Company earned $1.4 million and $0.9 million, respectively, in investment advisory fees from unconsolidated entities for which it acts as the investment manager.

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Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 4 Related Party Transactions (continued)

At both March 31, 2010 and December 31, 2009, the Company had $0.1 million remaining of an advance to an international investment company for organization and start-up costs, which is included in receivable from related parties on the consolidated statements of financial condition. The Company is the sponsor and investment manager of this entity.

At December 31, 2009, receivables from related parties included less than $0.1 million of loans to employees. No such loans existed at March 31, 2010. These loans were in the form of forgivable promissory notes, which were amortized through compensation expense pursuant to their terms. For each of the three months ended March 31, 2010 and 2009, less than $0.1 million of such amortization was recognized as compensation and benefits expense.

Certain qualified employees of the Company have the ability to open individual accounts, or invest in certain of the Company s consolidated investment partnerships, without being assessed advisory fees. Investments by employees in individual accounts are permitted only at the discretion of the executive committee of the Company, but are generally not subject to the same minimum investment levels that are required of outside investors.

On October 28, 2008, the Company issued an aggregate of $16.0 million principal amount of Senior Subordinated Notes to entities established by Richard S. Pzena, the Company s Chief Executive Officer, for the benefit of certain of his family members, an entity controlled by a Company Director, and a former employee. On December 31, 2009, the Company repaid a total of $6.0 million principal amount outstanding of Senior Subordinated Notes to the entity controlled by the Company Director and a former employee. On March 31, 2010, the Company repaid a total of $2.5 million principal amount outstanding of the Senior Subordinated Notes pro-rata to the entities established by Richard S. Pzena. At March 31, 2010, the remaining principal amount outstanding of the Senior Subordinated Notes was $7.5 million, all of which was held by the entities established by Richard S. Pzena.

Note 5 Commitments and Contingencies

In the normal course of business, the Company enters into agreements that include indemnities in favor of third parties, such as engagement letters with advisors and consultants. In certain cases, the Company may have recourse against third parties with respect to these indemnities. The Company maintains insurance policies that may provide coverage against certain claims under these indemnities. The *Guarantees Topic* of the FASB ASC provides accounting and disclosure requirements for certain guarantees. The Company has had no claims or payments pursuant to these agreements, and it believes the likelihood of a claim being made is remote. Utilizing the methodology in the *Guarantees Topic* of the FASB ASC, the Company s estimate of the value of such guarantees is de minimis; therefore, no accrual has been made in the consolidated financial statements.

The Company leases office space under a non-cancelable operating lease agreement which expires on October 31, 2015. The Company reflects minimum lease expense on a straight-line basis over the lease term. Lease expenses totaled $0.5 million and $0.6 million for the three months ended March 31, 2010 and 2009, respectively, and are included in general and administrative expenses.

Note 6 Compensation and Benefits

Compensation and benefits expense to employees and members is comprised of the following:

	For the Three Months Ended March 31, 2010	2009
	(in thousands)	
Cash Compensation and Other Benefits	$ 6,546	$ 5,789
Non-Cash Compensation	842	251
Total Compensation and Benefits Expense	$ 7,388	$ 6,040

For the three months ended March 31, 2010 and 2009, the Company granted no options to purchase capital units of the operating company and no options to purchase shares of Class A common stock pursuant to its 2006 Plan and 2007 Plan.

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Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 6 Compensation and Benefits (continued)

For the three months ended March 31, 2010 and 2009, the operating company granted 7,000 and 30,000, respectively, restricted Class B units to certain members pursuant to its 2006 Plan. These unit grants each vest ratably over a four-year period commencing January 1, 2010 and 2009, respectively. The amortization of these awards was not material for the three months ended March 31, 2010 and 2009.

Pursuant to the Pzena Investment Management, LLC Amended and Restated Bonus Plan (the Bonus Plan), which became effective January 1, 2007, eligible employees whose cash compensation is in excess of certain thresholds have a portion of that excess mandatorily deferred. Amounts deferred may be credited to an investment account, take the form of phantom Class B units, or be invested in money market funds at the employee s discretion, and vest ratably over four years. At March 31, 2010 and December 31, 2009, the liability associated with deferred compensation investment accounts was approximately $0.2 million and $0.4 million, respectively, and has been included as a component of other liabilities on the consolidated statement of financial condition. For the three months ended March 31, 2010 and 2009, the Company recognized approximately $0.3 million and $0.2 million, respectively, in compensation and benefits expense associated with the amortization of all deferred compensation awards.

As of March 31, 2010 and December 31, 2009, the Company had approximately $4.7 million and $5.3 million, respectively, in unrecorded compensation expense related to unvested operating company phantom units issued pursuant to our deferred compensation plan, operating company Class B unit and option grants issued under the Company s 2006 Plan, and stock option grants issued under our 2007 Plan.

Note 7 Short Term Borrowings

The operating company had a $1.8 million revolving credit facility that was terminated in September 2009. No balance was outstanding and no amounts were drawn down against the facility over the course of its existence.

Note 8 Term Loan

During the year ended December 31, 2009, the Company repaid the remaining $22.0 million of the principal amount outstanding under its term loan. Concurrently with the termination of this term loan, the security interest previously granted in the accounts receivable of the Company was released in September 2009.

Note 9 Interest Rate Swap

The Company manages its exposure to changes in market rates of interest. The Company s use of derivative instruments was limited to an interest rate swap used to manage the interest rate exposure related to the credit agreement, referenced above, which was terminated in September 2009.

On February 28, 2008, the Company entered into an interest rate swap agreement that commenced on July 23, 2008. This interest rate swap was subsequently unwound in conjunction with the termination of the credit agreement in September 2009. The swap obligated the Company to pay a 2.825% fixed rate of interest on the notional amount and required the counterparty to pay the Company a floating interest rate based on the monthly LIBOR interest rate. The spread on the credit agreement was in addition to these amounts.

During 2009, the Company reduced the notional amount of its interest rate swap in tandem with the reductions in principal amounts outstanding under a credit agreement. The amount paid to the counterparty in exchange for these reductions for the three months ended March 31, 2009 was approximately $0.2 million. For the three months ended March 31, 2009, the Company recognized approximately $0.1 million in other income associated with the change in fair value of the swap agreement.

Note 10 Income Taxes

The operating company is a limited liability company that has elected to be treated as a partnership for tax purposes. Neither it, nor the Company s other consolidated subsidiaries, has made a provision for federal or state income taxes because it is the individual responsibility of each of these entities members (including the Company) to separately report their proportionate share of the respective entity s taxable income or loss. The operating company has made a provision for New York City UBT. Subsequent to the offering and reorganization on October 30, 2007, the Company, as a C corporation under the Internal Revenue Code, is liable for

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Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 10 Income Taxes (continued)

federal, state, and local taxes on the income derived from its economic interest in its operating company, which is net of UBT. Correspondingly, in its consolidated financial statements, the Company reports both the operating company s provision for UBT, as well as its provision for federal, state, and local corporate taxes.

The components of the income tax benefit are as follows:

	For the Three Months Ended March 31, 2010		For the Three Months Ended March 31, 2009	
	(in thousands)			
Current Provision:				
Unincorporated Business Taxes	$	671	$	393
Local Corporate Tax				
State Corporate Tax				
Federal Corporate Tax				
Total Current Provision	$	671	$	393
Deferred Provision:				
Unincorporated Business Taxes	$	(56)	$	(55)
Local Corporate Tax		58		21
State Corporate Tax		111		41
Federal Corporate Tax		383		140
Total Deferred Provision	$	496	$	147
Change in Valuation Allowance		(1,266)		(814)
Total Income Tax Benefit	$	(99)	$	(274)

For the three months ended March 31, 2010 and 2009, the Company s taxable income/(loss) was determined as follows: