Pzena Investment Management, Inc.
Form 10-Q
November 02, 2011

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 September 30, 2011

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 x 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 November 2, 2011, there were 10,575,089 outstanding shares of the registrant’s Class A common stock, par value $0.01 per share.

As of November 2, 2011, there were 53,995,585 outstanding shares of the registrant’s Class B common stock, par value $0.000001 per share.

PZENA INVESTMENT MANAGEMENT, INC.
FORM 10-Q
TABLE OF CONTENTS

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,” “expect,” “intend,” “may,” “plan,” “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, 2010. 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.

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			
		September 30, 2011 (unaudited)		December 31, 2010
Assets				
Cash and Cash Equivalents	$	36,862	$	16,381
Restricted Cash		1,423		1,420
Due from Broker		31		30
Advisory Fees Receivable		15,302		15,275
Investments, at Fair Value		5,341		3,323
Receivable from Related Parties		63		63
Other Receivables		194		210
Prepaid Expenses and Other Assets		509		914
Deferred Tax Asset, Net of Valuation Allowance of $60,282 and $59,431, respectively		9,859		8,834
Property and Equipment, Net of Accumulated Depreciation of $3,024 and $2,727, respectively		1,796		1,952
TOTAL ASSETS	$	71,380	$	48,402
LIABILITIES AND EQUITY				
Liabilities:				
Accounts Payable and Accrued Expenses	$	13,114	$	3,879
Due to Broker		32		—
Liability to Selling and Converting Shareholders		11,944		9,287
Deferred Compensation Liability		879		875
Other Liabilities		486		565
TOTAL LIABILITIES		26,455		14,606
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; 10,575,089 and 9,367,659 Shares Issued and Outstanding in 2011 and 2010, respectively)		105		93
Class B Common Stock (Par Value $0.000001; 750,000,000 Shares Authorized; 53,812,799 and 55,012,324 Shares Issued and Outstanding in 2011 and 2010, respectively)		—		—
Additional Paid-In Capital		11,866		10,836
Retained Earnings/(Accumulated Deficit)		1,780		(357)

Total Pzena Investment Mangement, Inc.'s Equity		13,751		10,572
Non-Controlling Interests		31,174		23,224
TOTAL EQUITY		44,925		33,796
TOTAL LIABILITIES AND EQUITY	$	71,380	$	48,402

See accompanying notes to consolidated financial statements.

PZENA INVESTMENT MANAGEMENT, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per-share amounts)

	For the Three Months Ended September 30, 2011	For the Three Months Ended September 30, 2010	For the Nine Months Ended September 30, 2011	For the Nine Months Ended September 30, 2010
REVENUE	$ 19,950	$ 18,482	$ 64,109	$ 57,020
EXPENSES				
Compensation and Benefits Expense	7,727	7,375	24,375	22,026
General and Administrative Expense	1,969	1,837	5,972	5,927
TOTAL OPERATING EXPENSES	9,696	9,212	30,347	27,953
Operating Income	10,254	9,270	33,762	29,067
OTHER INCOME/(EXPENSE)				
Interest Income	72	60	144	145
Dividend Income	29	25	100	125
Interest Expense	—	—	—	(232)
Net Realized and Unrealized Gain/(Loss) from Investments	(1,150)	544	(709)	137
Change in Liability to Selling and Converting Shareholders	(50)	(1,725)	(2,307)	(1,633)
Other Income/(Expense)	(61)	3	(232)	72
Total Other Expense	(1,160)	(1,093)	(3,004)	(1,386)
Income Before Income Taxes	9,094	8,177	30,758	27,681
Income Tax Expense/(Benefit)	1,500	(1,075)	1,567	1,373
Net Income	7,594	9,252	29,191	26,308
Less: Net Income Attributable to Non-Controlling Interests	7,097	8,033	26,178	23,632
Net Income Attributable to Pzena Investment Management, Inc.	$ 497	$ 1,219	$ 3,013	$ 2,676
Net Income for Basic Earnings per Share	$ 497	$ 1,219	$ 3,013	$ 2,676
Basic Earnings per Share	$ 0.05	$ 0.13	$ 0.31	$ 0.29
Basic Weighted Average Shares Outstanding	10,013,573	9,367,659	9,770,068	9,125,477
Net Income for Diluted Earnings per Share	$ 497	$ 5,632	$ 18,350	$ 16,096
Diluted Earnings per Share	$ 0.05	$ 0.09	$ 0.28	$ 0.25
Diluted Weighted Average Shares Outstanding	10,013,573	64,993,746	65,011,182	65,006,198

Cash Dividends per Share of Class A Common Stock	$ 0.03	$ 0.03	$ 0.09	$ 0.06

See accompanying notes to consolidated financial statements.

PZENA INVESTMENT MANAGEMENT, INC.
UNAUDITED CONSOLIDATED STATEMENTS 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	Retained Earnings/ (Accumulated Deficit)	Non-Controlling Interests	Total
Balance at December 31, 2010	9,367,659	55,012,324	$ 93	$ 10,836	$ (357)	$ 23,224	$ 33,796
Unit Conversion	1,207,430	(1,207,430)	12	727	—	(662)	77
Retirement of Class B Units	—	(1,095)	—	(1)	—	(3)	(4)
Directors' Shares	—	—	—	32	—	178	210
Amortization of Non-Cash Compensation	—	9,000	—	383	—	2,141	2,524
Net Income	—	—	—	—	3,013	26,178	29,191
Contributions from Non-Controlling Interests	—	—	—	—	—	450	450
Distributions to Non-Controlling Interests	—	—	—	(111)	—	(22,750)	(22,861)
Effect of Consolidation of Affiliates	—	—	—	—	—	2,418	2,418
Class A Cash Dividends Declared and Paid ($0.09 per share)	—	—	—	—	(876)	—	(876)
Balance at September 30, 2011	10,575,089	53,812,799	$ 105	$ 11,866	$ 1,780	$ 31,174	$ 44,925

See accompanying notes to consolidated financial statements.

PZENA INVESTMENT MANAGEMENT, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Three Months Ended September 30, 2011	For the Three Months Ended September 30, 2010	For the Nine Months Ended September 30, 2011	For the Nine Months Ended September 30, 2010
OPERATING ACTIVITIES				
Net Income	$ 7,594	$ 9,252	$ 29,191	$ 26,308
Adjustments to Reconcile Net Income to Cash Provided by Operating Activities:				
Depreciation	104	108	311	322
Non-Cash Compensation	1,039	901	3,402	2,565
Director Share Grant	70	14	210	41
Net Realized and Unrealized Loss/(Gain) from Investments	1,150	(544)	709	(137)
Change in Liability to Selling and Converting Shareholders	50	1,725	2,307	1,633
Deferred Income Taxes	905	(1,677)	(534)	(579)
Changes in Operating Assets and Liabilities:				
Advisory Fees Receivable	2,027	(928)	(27)	(870)
Due from Broker	2,064	58	401	103
Restricted Cash	(1)	(4)	(3)	(13)
Prepaid Expenses and Other Assets	112	16	428	(120)
Due to Broker	23	(79)	26	(715)
Accounts Payable, Accrued Expenses, and Other Liabilities	3,519	3,110	8,301	7,473
Tax Receivable Agreement Payments	—	—	(84)	—
Purchases of Investments	(6,513)	(294)	(26,928)	(3,805)
Proceeds from Sale of Investments	6,361	304	26,754	7,279
Net Cash Provided by Operating Activities	18,504	11,962	44,464	39,485
INVESTING ACTIVITIES				
Purchases of Deferred Compensation	—	(2,042)	(1,433)	(2,042)
Proceeds from Deferred Compensation	—	—	847	—
Receivable from Related Parties	(22)	(13)	—	27
Purchase of Property and Equipment	(4)	(3)	(155)	(13)
Net Cash Used In Investing Activities	(26)	(2,058)	(741)	(2,028)
FINANCING ACTIVITIES				
Distributions to Non-Controlling Interests	(6,710)	(6,322)	(22,860)	(20,225)
Contributions from Non-Controlling Interests	200	—	450	4,321

Retirement of Class B Units	(4)	—	(4)	(2)
Term Loan and Senior Subordinated Notes Repayment	—	—	—	(10,000)
Dividends	(298)	(281)	(876)	(562)
Net Cash Used in Financing Activities	(6,812)	(6,603)	(23,290)	(26,468)
NET CHANGE IN CASH	$ 11,666	$ 3,301	$ 20,433	$ 10,989
CASH AND CASH EQUIVALENTS - Beginning of Period	$ 25,196	$ 23,596	$ 16,381	$ 15,908
Effect of Consolidation/(Deconsolidation) of Affiliates	—	(96)	48	(96)
Net Change in Cash	11,666	3,301	20,433	10,989
CASH AND CASH EQUIVALENTS - End of Period	$ 36,862	$ 26,801	$ 36,862	$ 26,801
Supplementary Cash Flow Information:				
Interest Paid	$ —	$ —	$ —	$ 232
Income Taxes Paid	$ 757	$ 643	$ 2,877	$ 2,597

See accompanying notes to consolidated financial statements.

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 (the "operating company"), is conducted. Concurrently with the consummation of the Company's initial public offering on October 30, 2007, the operating agreement of the operating company was amended and restated such that, among other things, the Company became the sole managing member of the operating company. As a result of these transactions: (i) the Company has consolidated the financial results of the operating company 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 the operating company'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 September 30, 2011, the operating 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 entities as of September 30, 2011:

Legal Entity	Type of Entity (Date of Formation)	Operating Company's Ownership at September 30, 2011
Pzena Investment Management, PTY	Australian Proprietary Limited Company (12/16/2009)	100.0%
Pzena Investment Management Special Situations, LLC	Delaware Limited Liability Company (12/01/2010)	99.9%
Pzena Large Cap Value Fund	Massachusetts Trust (11/01/2002)	0.0%
Pzena International Value Service	Delaware Limited Liability Company (12/22/2003)	0.0%

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, which includes the Pzena Investment Management Special Situations, LLC, and the Pzena Investment Management, PTY, as well as variable-interest entities ("VIEs") where the Company is deemed to be the primary beneficiary, which includes the Pzena Large Cap Value Fund and the Pzena International Value Service. These majority-owned subsidiaries in which the Company has a controlling financial interest and VIEs where the Company is deemed to be the primary beneficiary are collectively referred to as "consolidated subsidiaries." As required by the Consolidation Topic of the

Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC"), the Company also consolidates or consolidated non-variable-interest entities in which it acts or acted as the general partner or managing member. All of these entities represent or represented 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 operating company is the managing member of the Europe, Australasia, and Far East ("EAFE") Value Service (legally known as Pzena International Value Service), a limited liability company. Neither the Company, nor the operating company, holds an equity ownership percentage in this entity at September 30, 2011, or held an equity ownership percentage during the periods presented. Since the holders of the equity investment in this partnership lack a controlling financial interest, this entity is deemed a VIE. As of February 1, 2011, as a result of a shift in the equity ownership of the entity on that date, the operating company was considered the primary beneficiary of this entity. Correspondingly, the entity was consolidated as of February 1, 2011. At September 30, 2011, EAFE Value Service's $1.9 million in net assets were included in the Company's consolidated statements of financial condition.

Pzena Large Cap Value Fund is a Massachusetts Trust in which a majority of the trustees are members of the executive committee of the operating company. A majority of the trustees are not the holders of the equity investment in this Trust. Since the holders of the equity investment in this partnership lack a controlling financial interest, this entity is deemed a VIE. The Company is considered the primary beneficiary of this VIE. At September 30, 2011, Pzena Large Cap Value Fund's $0.7 million of net assets were included in the Company's consolidated statements of financial condition.

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 of Partnerships and Similar Entities Subtopic of the FASB ASC. Thus, the Company reports these 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.

VIEs that are not consolidated continue to receive investment management services from the Company, and are vehicles through which the Company offers its Global Value and/or EAFE Value strategies. The total net assets of these VIEs was approximately $206.0 million and $515.6 million at September 30, 2011 and December 31, 2010, respectively. Neither the Company nor the operating company were exposed to losses as a result of its involvement with these entities because they had no direct investment in them.

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.

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 are presented at 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 performance fees that may be earned by the Company depending on the investment return of the assets under management. Performance 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 performance fees earned. In general, returns are calculated on an annualized basis over the contract's measurement period, which usually extends to three years. Performance fees are generally payable annually. Following the preferred method identified in the Revenue Recognition Topic of the FASB ASC, such performance fee income is recorded at the conclusion of the contractual performance period, when all contingencies are resolved. For the three months ended September 30, 2011, the Company recognized approximately $1.1 million in performance fee income. No such income was recognized for the three months ended September 30, 2010. For the nine months ended September 30, 2011 and 2010, the Company recognized approximately $2.5 million and $0.3 million, respectively, in performance fee income.

Earnings per Share:

Basic earnings per share is computed by dividing the Company's net income or loss attributable to its 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 membership units, as well as operating company phantom units and outstanding operating company unit options and options to purchase Class A Common Stock, to the extent they would have a dilutive effect on net income per share for the reporting period. Net income or loss for diluted earnings per share generally assumes all operating company membership 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, exclusive of adjustments associated with both the valuation allowance and the liability to selling and converting shareholders. When this conversion results in an increase in earnings per share or a decrease in loss per share, diluted net income and diluted earnings per share are assumed to be equal to basic net income and basic earnings per share for the reporting period.

For the three and nine months ended September 30, 2011 and 2010, the Company's diluted net income was determined as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
	(in thousands)			
Non-Controlling Interests of Pzena Investment Management, LLC	$7,811	$7,722	$26,841	$23,483
Less: Assumed Corporate Income Taxes	3,348	3,309	11,504	10,063
Assumed After-Tax Income of Pzena Investment Management, LLC	$4,463	$4,413	$15,337	$13,420
Assumed After-Tax Income of Pzena Investment Management, LLC	$4,463	$4,413	$15,337	$13,420
Net Income of Pzena Investment Management, Inc.	497	1,219	3,013	2,676
Diluted Net Income(1)	$4,960	$5,632	$18,350	$16,096

(1) Since the assumed incremental income results in an increase in per share income for the three months ended September 30, 2011, diluted net income and diluted earnings per share are assumed to be equal to basic net income and basic earnings per share for the reporting period.

For the three and nine months ended September 30, 2011 and 2010, the following operating company units, options to purchase operating company units and shares of Class A common stock, and 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 respective periods:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
Operating Company Units	54,375,231	—	—	—
Options to Purchase Operating Company Units	3,648,117	1,620,060	1,653,060	1,620,060
Options to Purchase Shares of Class A Common Stock	961,750	961,750	961,750	961,750
Phantom Operating Company Units	152,701	44,916	30,000	44,916
Total	59,137,799	2,626,726	2,644,810	2,626,726

For the three and nine months ended September 30, 2011 and 2010, the Company's basic and diluted earnings per share were determined as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010

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

Net Income for Basic Earnings per Share	$ 497	$ 1,219	$ 3,013	$ 2,676
Basic Weighted Average Shares Outstanding	10,013,573	9,367,659	9,770,068	9,125,477
Basic Earnings per Share	$ 0.05	$ 0.13	$ 0.31	$ 0.29
Net Income for Diluted Earnings per Share	$ 497	$ 5,632	$ 18,350	$ 16,096
Dilutive Effect of Operating Company B Units(1)	—	54,960,418	54,618,934	55,202,995
Dilutive Effect of Options(1)	—	638,779	603,567	656,538
Dilutive Effect of Phantom Units(1)	—	26,890	18,613	21,188
Diluted Weighted Average Shares Outstanding	10,013,573	64,993,746	65,011,182	65,006,198
Diluted Earnings per Share	$ 0.05	$ 0.09	$ 0.28	$ 0.25

(1) Since the assumed incremental income results in an increase in per share income for the three months ended September 30, 2011, the assumed effects of the conversion of operating company Class B units, options to purchase operating company units, options to purchase Class A common stock, and phantom operating company units are excluded from the calculation of diluted income per share.

Cash and Cash Equivalents:

At September 30, 2011, cash and cash equivalents was $36.9 million. The Company considers all money market funds and 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 in the consolidated statements of operations.

Restricted Cash:

The Company maintains a compensating balance of $1.4 million at September 30, 2011 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 amount is recorded in restricted cash in 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, at Fair Value:

Investments, at Fair Value represents the securities held by the Company and its consolidated investment partnerships, as well as investments in mutual funds. All such investments 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.

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

The following table presents these instruments' fair value at September 30, 2011:

	Level 1	Level 2	Level 3
		(in thousands)	

	Level 1		Level 2		Level 3	
Assets:						
Equity Securities	$	2,588	$	—	$	—
Investments in Mutual Funds		2,753		—		—
Total Fair Value	$	5,341	$	—	$	—

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

	Level 1		Level 2 (in thousands)		Level 3	
Assets:						
Equity Securities	$	842	$	—	$	—
Investments in Mutual Funds		2,481		—		—
Total Fair Value	$	3,323	$	—	$	—

Securities Valuation:

Investments in equity securities for which market quotations are available are valued at the last reported price or closing price on the primary market or exchange on which they trade. If no reported equity sales occurred on the valuation date, equity investments are valued at the bid price. Investments in mutual funds are valued at the closing net asset value per share of the fund on the day of valuation. Transactions are recorded on the trade date.

The net realized gain or loss on sales of securities and mutual funds is determined on a specific identification basis and is included in net realized and unrealized gain/(loss) from investments 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 September 30, 2011 and 2010, approximately 7.1% and 10.4%, respectively, of the Company's advisory fees were generated from an advisory agreement with one client. For the nine months ended September 30, 2011 and 2010, approximately 7.9% and 10.1%, respectively, of the Company's advisory fees were generated from an advisory agreement with one client. At September 30, 2011 and December 31, 2010, no allowance for doubtful accounts has been deemed necessary.

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 September 30, 2011, the Company had a $60.3 million valuation allowance against deferred tax assets 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, 2010, the Company had a $59.4 million valuation allowance against these deferred tax assets. The income tax expense, 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 in 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 the portion of the results of its operations resulting from the impact of changes in foreign exchange rates on its investments, from the fluctuations arising from changes in market prices of securities held. Such fluctuations are included in net realized and unrealized gain/(loss) on investments in the consolidated statements of operations.

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.

The functional currency of the Company is the United States Dollar. The functional currency of the Company's representative office in Australia is the Australian Dollar. Assets and liabilities of this office are translated at the spot rate in effect at the applicable reporting date, and the consolidated statements of operations are translated at the average exchange rates in effect during the applicable period. Any resulting unrealized cumulative translation adjustment is recorded net of taxes as a component of accumulated other comprehensive income in equity. As of September 30, 2011, the Company did not record any accumulated other comprehensive income.

Note 3—Property and Equipment

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

	As of September 30, 2011	As of December 31, 2010
	(in thousands)	
Leasehold Improvements	$ 2,145	$ 2,145
Furniture and Fixtures	1,164	1,164
Computer Hardware	1,026	887
Office Equipment	271	271
Computer Software	214	212
Total	4,820	4,679
Less: Accumulated Depreciation and Amortization	(3,024)	(2,727)
Total	$ 1,796	$ 1,952

Depreciation is included in general and administrative expense and totaled $0.1 million for each of the three months ended September 30, 2011 and 2010. Such expenses totaled $0.3 million for each of the nine months ended September 30, 2011 and 2010.

Note 4—Related Party Transactions

For the three months ended September 30, 2011 and 2010, the Company earned $0.5 million and $1.1 million, respectively, in investment advisory fees from unconsolidated VIEs which receive investment management services from the Company. For the nine months ended September 30, 2011 and 2010, the Company earned $2.1 million and $3.2 million, respectively, in such fees. The Company is not the primary beneficiary of these VIEs.

At both September 30, 2011 and December 31, 2010, the Company had less than $0.1 million remaining of advances to an international investment company for organization and start-up costs, which are included in receivable from related parties on the consolidated statements of financial condition. The Company is the sponsor and investment manager of this entity. This entity is included in the previously mentioned unconsolidated VIEs, of which the Company is not considered the primary beneficiary.

At September 30, 2011 and December 31, 2010, receivables from related parties included less than $0.1 million of loans to employees. The Company has, in the past, issued loans that were in the form of forgivable promissory notes, which were amortized through compensation expense pursuant to their terms. For the nine months ended September 30, 2010, less than $0.1 million of such amortization was recognized through compensation and benefits expense. No such amortization was recognized for the three months ended September 30, 2010. The Company did not have any forgivable promissory notes at September 30, 2011 or December 31, 2010.

On October 28, 2008, the operating 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. The Notes were repaid in full during the year ended December 31, 2010.