

Pzena Investment Management, Inc.
Form 10-Q
May 06, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended March 31, 2016

Or

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 (I.R.S. Employer
Incorporation or Organization) Identification No.)
320 Park Avenue
New York, New York 10022
(Address of Principal Executive Offices) (Zip Code)
Registrant's telephone number, including area code: (212) 355-1600

Not Applicable

(Former Address of Principal Executive Offices) (Zip Code)

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data 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 No

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 Accelerated filer

Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

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As of May 5, 2016, there were 15,067,443 outstanding shares of the registrant's Class A common stock, par value \$0.01 per share.

As of May 5, 2016, there were 52,164,667 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,” “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, 2015. 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 ability to respond to global economic, market, business and geopolitical conditions;
 - our anticipated future results of operations and operating cash flows;
 - our successful formulation and execution of 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;
 - our ability to identify and capture potential growth opportunities available to us;
 - the effective recruitment and retention of our key executives and 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, 2016	December 31, 2015
	(unaudited)	
ASSETS		
Cash and Cash Equivalents	\$20,470	\$ 35,417
Restricted Cash	3,418	3,552
Due from Broker	205	297
Advisory Fees Receivable	21,305	22,248
Investments	18,302	27,452
Receivable from Related Parties	1,189	1,054
Other Receivables	590	589
Prepaid Expenses and Other Assets	1,031	802
Deferred Tax Asset, Net of Valuation Allowance of \$52,908 and \$53,968, respectively	15,217	14,995
Property and Equipment, Net of Accumulated Depreciation of \$1,470 and \$1,202, respectively	7,713	7,903
TOTAL ASSETS	\$89,440	\$ 114,309
LIABILITIES AND EQUITY		
Liabilities:		
Accounts Payable and Accrued Expenses	\$9,856	\$ 7,885
Due to Broker	181	30
Securities Sold Short, at Fair Value	2,555	2,231
Liability to Selling and Converting Shareholders	15,953	15,075
Deferred Compensation Liability	900	2,896
Other Liabilities	823	730
TOTAL LIABILITIES	30,268	28,847
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; 15,142,771 and 15,218,355 Shares Issued and Outstanding in 2016 and 2015, respectively)	151	152
Class B Common Stock (Par Value \$0.000001; 750,000,000 Shares Authorized; 52,122,683 and 52,089,472 Shares Issued and Outstanding in 2016 and 2015, respectively)	—	—
Additional Paid-In Capital	5,224	5,819
Retained Earnings	9,224	12,453
Accumulated Other Comprehensive Loss	(3	) (2
Total Pzena Investment Management, Inc.'s Equity	14,596	18,422
Non-Controlling Interests	44,576	67,040
TOTAL EQUITY	59,172	85,462
TOTAL LIABILITIES AND EQUITY	\$89,440	\$ 114,309

See accompanying notes to unaudited 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,	
	2016	2015
REVENUE	\$25,838	\$ 28,653
EXPENSES		
Compensation and Benefits Expense	12,498	12,070
General and Administrative Expense	3,044	3,603
Total Operating Expenses	15,542	15,673
Operating Income	10,296	12,980
OTHER INCOME/ (EXPENSE)		
Interest Income	9	14
Dividend Income	87	118
Gains/ (Losses) and Other Investment Income	104	15
Change in Liability to Selling and Converting Shareholders	(878)	(245)
Other Expense	(40)	(191)
Total Other Expense	(718)	(289)
Income Before Income Taxes	9,578	12,691
Income Tax Expense	220	1,088
Net Income	9,358	11,603
Less: Net Income Attributable to Non-Controlling Interests	7,736	9,981
Net Income Attributable to Pzena Investment Management, Inc.	\$ 1,622	\$ 1,622
Net Income for Basic Earnings per Share	\$1,622	\$ 1,622
Basic Earnings per Share	\$0.11	\$ 0.12
Basic Weighted Average Shares Outstanding ¹	15,192,511	13,057,714
Net Income for Diluted Earnings per Share	\$6,510	\$ 7,927
Diluted Earnings per Share	\$0.10	\$ 0.12
Diluted Weighted Average Shares Outstanding ¹	68,496,511	67,982,245
Cash Dividends per Share of Class A Common Stock	\$0.32	\$ 0.32

¹ The Company issues restricted shares of Class A common stock and restricted Class B units that have non-forfeitable dividend rights. Under the "two-class method," these shares and units are considered participating securities and are required to be included in the computation of basic and diluted earnings per share.

See accompanying notes to unaudited consolidated financial statements.

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PZENA INVESTMENT MANAGEMENT, INC.
 UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (in thousands)

	For the Three Months Ended March 31,	
	2016	2015
NET INCOME	\$9,358	\$11,603
OTHER COMPREHENSIVE LOSS		
Foreign Currency Translation Adjustment	(5) —
Total Other Comprehensive Loss	(5) —
Comprehensive Income	9,353	11,603
Less: Comprehensive Income Attributable to Non-Controlling Interests	7,732	9,981
Total Comprehensive Income Attributable to Pzena Investment Management, Inc.	\$1,621	\$1,622

See accompanying notes to unaudited consolidated financial statements.

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PZENA INVESTMENT MANAGEMENT, INC.
 UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
 (in thousands, except share and per-share amounts)

	Shares of Class A Common Stock	Shares of Class B Common Stock	Class A Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Non-Controlling Interests	Total Equity
Balance at December 31, 2015	15,218,355	52,089,472	\$ 152	\$ 5,819	\$ (2)	\$ 12,453	\$ 67,040	\$ 85,462
Adjustment for the Cumulative Effect of Applying ASU 2015-02 for the Deconsolidation of a Legal Entity	—	—	—	—	—	—	(10,835)	(10,835)
Adjusted Balance at January 1, 2016	15,218,355	52,089,472	152	5,819	(2)	12,453	56,205	74,627
Amortization of Non-Cash Compensation	24,934	22,723	—	190	—	—	511	701
Sale of Shares under Equity Incentive Plan	—	12,695	—	11	—	—	37	48
Directors' Share Grants	—	—	—	40	—	—	138	178
Net Income	—	—	—	—	—	1,622	7,736	9,358
Foreign Currency Translation Adjustments	—	—	—	—	(1)	—	(4)	(5)
Repurchase and Retirement of Class A Common Stock	(100,518)	—	(1)	(752)	—	—	—	(753)
Repurchase and Retirement of Class B Units	—	(2,207)	—	(4)	—	—	(15)	(19)
Class A Cash Dividends Declared and Paid (\$0.32 per share)	—	—	—	—	—	(4,851)	—	(4,851)
Contributions from Non-Controlling Interests	—	—	—	—	—	—	271	271
Distributions to Non-Controlling Interests	—	—	—	—	—	—	(20,383)	(20,383)
Other	—	—	—	(80)	—	—	80	—
Balance at March 31, 2016	15,142,771	52,122,683	\$ 151	\$ 5,224	\$ (3)	\$ 9,224	\$ 44,576	\$ 59,172

See accompanying notes to unaudited 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,	
	2016	2015
OPERATING ACTIVITIES		
Net Income	\$9,358	\$11,603
Adjustments to Reconcile Net Income to Cash Provided by Operating Activities:		
Depreciation	267	65
Non-Cash Compensation	1,601	1,473
Directors' Share Grants	178	146
(Gains)/ Losses and Other Investment Income	(104	) (15
Foreign Currency Translation Adjustments	(5) —
Change in Liability to Selling and Converting Shareholders	878	245
Deferred Income Taxes	(223	) 626
Changes in Operating Assets and Liabilities:		
Advisory Fees Receivable	943	(75
Due from Broker	89	(607
Restricted Cash	134	(675
Prepaid Expenses and Other Assets	(286	) (262
Non-Cash Compensation Modification	—	(713
Due to Broker	144	54
Accounts Payable, Accrued Expenses, and Other Liabilities	(749	) 849
Change in Lease Liability	—	(106
Purchases of Equity Securities and Securities Sold Short	(4,973	) (17,511
Proceeds from Equity Securities and Securities Sold Short	4,909	12,824
Net Cash Provided by Operating Activities	12,161	7,921
INVESTING ACTIVITIES		
Purchases of Investments	(1,741	) (4,535
Proceeds from Sale of Investments	759	5,771
Payments to Related Parties	(135	) (198
Purchases of Property and Equipment	(77	) (3,290
Net Cash Used in Investing Activities	(1,194	) (2,252
FINANCING ACTIVITIES		
Repurchase and Retirement of Class A Common Stock	(753	) (825
Repurchase and Retirement of Class B Units	(19	) (42
Sale of Shares under Equity Incentive Plan	48	—
Option Exercise	—	1,688
Distributions to Non-Controlling Interests	(20,383	) (20,653
Contributions from Non-Controlling Interests	271	336
Dividends	(4,851	) (4,177
Net Cash Used in Financing Activities	(25,687	) (23,673
NET CHANGE IN CASH	\$(14,720)	\$(18,004)
CASH AND CASH EQUIVALENTS - Beginning of Period	\$35,417	\$39,109
	(227) —

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Adjustment for the Cumulative Effect of Applying ASU 2015-02 for the Deconsolidation of a
Legal Entity

Net Change in Cash	(14,720)	(18,004)
CASH AND CASH EQUIVALENTS - End of Period	\$20,470	\$21,105
Supplementary Cash Flow Information:		
Income Taxes Paid	\$246	\$409

See accompanying notes to unaudited consolidated financial statements.

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Pzena Investment Management, Inc.

Notes to Unaudited Consolidated Financial Statements

Note 1—Organization

Pzena Investment Management, Inc. (the “Company”) is the sole managing member of its operating company, Pzena Investment Management, LLC (the “operating company”). As a result, the Company: (i) consolidates the financial results of the operating company and reflects the membership interests that it does not own as a non-controlling interest in its consolidated financial statements; and (ii) recognizes income generated from its economic interest in the operating company’s net income.

The operating company is an investment adviser registered under the Investment Advisers Act of 1940 and is headquartered in New York, New York. As of March 31, 2016, 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 also serves as the general partner of Pzena Investment Management, LP, a partnership formed with the objective of aggregating employee ownership in the operating company into one entity.

The Company, through its interest in the operating company, has consolidated the results of operations and financial condition of the following entities as of March 31, 2016:

Legal Entity	Type of Entity (Date of Formation)	Ownership at March 31, 2016	
Pzena Investment Management, Pty	Australian Proprietary Limited Company (12/16/2009)	100.0	%
Pzena Financial Services, LLC	Delaware Limited Liability Company (10/15/2013)	100.0	%
Pzena Investment Management, LTD	England and Wales Private Limited Company (01/08/2015)	100.0	%
Pzena Investment Management Special Situations, LLC	Delaware Limited Liability Company (12/01/2010)	99.9	%
Pzena Mid Cap Focused Value Fund, a series of Advisors Series Trust	Open-end Management Investment Company, series of Delaware Statutory Trust (3/31/2014)	87.6	%
Pzena Long/Short Value Fund, a series of Advisors Series Trust	Open-end Management Investment Company, series of Delaware Statutory Trust (3/31/2014)	81.4	%
Pzena International Value Service, a series of Pzena Investment Management International, LLC	Delaware Limited Liability Company (12/22/2003)	53.5	%

Note 2—Significant Accounting Policies

Basis of Presentation:

Principles of Consolidation:

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 those entities in which it has a direct or indirect controlling financial interest based on either a variable interest model or a voting interest model. As such, the Company consolidates majority-owned subsidiaries in which it

has a controlling financial interest, and certain investment vehicles the operating company sponsors for which it is the investment adviser that are considered to be variable-interest entities (“VIEs”) and for which the Company is deemed to be the primary beneficiary.

For equity investments where the Company does not control the investee, and where it is not the primary beneficiary of a VIE, but can exert significant influence over the financial and operating policies of the investee, the Company follows the equity method of accounting. The evaluation of whether the Company exerts control or significant influence over the financial and operating policies of the investee requires significant judgment based on the facts and circumstances surrounding each investment. Factors considered in these evaluations may include the type of investment, the legal structure of the investee, the terms of the investment agreement, or other agreements with the investee.

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Pzena Investment Management, Inc.

Notes to Unaudited Consolidated Financial Statements (Continued)

Adoption of ASU 2015-02

Effective January 1, 2016, the Company adopted Financial Accounting Standards Board ("FASB") Accounting Standards Update No. 2015-02, Amendments to the Consolidation Analysis ("ASU 2015-02") under the modified retrospective approach. Restatement of prior period results is not required.

For legal entities evaluated for consolidation, the Company must determine whether interests it holds and fees paid to it qualify as a variable interest. Pursuant to ASU 2015-02, fees, including fees that are determined based on expense reimbursements, that are customary and commensurate with the level of services provided are not considered a variable interest when the Company does not hold other economic interests in the entity that would absorb more than an insignificant amount of the expected losses or returns of the entity. The Company factors in all economic interests, including proportionate interests through related parties, to determine if fees are considered a variable interests. If it is determined that the Company does not have a variable interest in the entity, no further analysis is required and the Company does not consolidate the entity. If it is determined that the Company has a variable interest, it considers its direct economic interests and the proportionate indirect interests through related parties to determine if it is the primary beneficiary of the VIE.

Also pursuant to ASU 2015-02, the FASB clarifies the treatment of entities structured as series funds which comply with the requirements included in the Investment Company Act of 1940 for registered mutual funds. These entities are now considered voting interest entities because the shareholders are deemed to have the ability to direct the activities of the fund that most significantly impact the fund's economic performance.

As a result of the adoption of ASU 2015-02, the Company deconsolidated certain previously consolidated entities as the Company either did not have a variable interest in the entity or the Company did not own more than 50% of a series fund now required to be considered for consolidation under the voting interest model. In addition, upon adoption of ASU 2015-02, the Company is no longer considered to have fee-based variable interests in certain private investment partnerships the operating company sponsors and these entities are no longer considered VIE's.

Consolidated Entities

The Company consolidates the financial results of the operating company and records in its own equity its pro-rata share of transactions that impact the operating company's net equity, including unit and option issuances, repurchases, and retirements. The operating company's pro-rata share of such transactions are recorded as an adjustment to additional paid-in capital or non-controlling interests, as applicable, on the consolidated statements of financial position.

The majority-owned subsidiaries in which the Company, through its interest in the operating company, has a controlling financial interest and the VIEs for which the Company is deemed to be the primary beneficiary are collectively referred to as "consolidated subsidiaries." 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 through consolidation.

During 2014, the Company provided the initial cash investment for the Pzena Mutual Funds in an effort to generate an investment performance track record to attract third-party investors. Due to their series fund structure, registration, and compliance with the requirements of the Investment Company Act of 1940, these funds are analyzed for consolidation

under the voting interest model. As a result of the Company's interests, it consolidates the Pzena Mid Cap Value Fund, and Pzena Long/Short Value Fund. These funds will continue to be consolidated to the extent the Company is deemed to control them. At March 31, 2016, the aggregate of these funds' \$7.4 million in net assets was included in the Company's consolidated statement of financial condition.

The operating company is the managing member of Pzena International Value Service, a series of Pzena Investment Management International, LLC. The operating company is considered the primary beneficiary of this entity. At March 31, 2016, Pzena International Value Service's \$3.1 million in net assets were included in the Company's consolidated statement of financial condition.

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Pzena Investment Management, Inc.

Notes to Unaudited Consolidated Financial Statements (Continued)

Deconsolidated Entities

Certain funds that have historically been consolidated in the financial statements are no longer consolidated. The Company had consolidated the Pzena Investment Funds Trust, Pzena Large Cap Value Fund ("Pzena Large Cap Value Fund") in its consolidated financial statements in accordance with the Consolidation Topic of the FASB Accounting Standards Codification ("FASB ASC"). The majority of the trustees are members of the executive committee of the operating company. The Company reconsidered the consolidation conclusion for the Pzena Large Cap Value Fund as a result of ASU 2015-02 and determined that, although the Pzena Large Cap Value Fund continues to be a VIE, the Company is no longer considered the primary beneficiary.

Prior to January 1, 2016, the Company had consolidated the Pzena Emerging Markets Value Fund as the fund previously met the definition of VIE due to its series fund structure, as the shareholders of the fund lacked the ability to make decisions regarding the trustees and key activities of the fund. The Company reconsidered the consolidation conclusion as a result of the new guidance and determined that, as the Pzena Emerging Markets Value Fund is a series and registered mutual fund that complies with the requirements of the Investment Company Act of 1940, it will be analyzed for consolidation under the voting interest model. The Company is not deemed to control the Pzena Emerging Markets Value Fund.

The deconsolidation of these previously consolidated entities had the following impact on the consolidated statement of financial condition as of January 1, 2016:

	As of December 31, 2015	Impact of Deconsolidation	Adjusted as of January 1, 2016
	(in thousands)		
Number of entities	11	(2	) 9
Total Assets	\$114,309	\$ (10,910	) \$103,399
Total Liabilities	\$28,847	\$ (75	) \$28,772
Total Equity	\$85,462	\$ (10,835	) \$74,627

Non-Consolidated Variable Interest Entities

VIEs that are not consolidated receive investment management services from the operating company and are generally private investment partnerships sponsored by the operating company. The total net assets of these VIEs was approximately \$40.3 million and \$390.1 million at March 31, 2016 and December 31, 2015, respectively.

As of March 31, 2016 and December 31, 2015, in order to satisfy the Company's obligations under its deferred compensation programs, the operating company had \$2.8 million and \$1.7 million in investments, respectively, in certain of these firm-sponsored vehicles, for which the Company was not deemed to be primary beneficiary.

Management's Use of Estimates:

The preparation of consolidated 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 consolidated financial statements, and the reported amounts of revenues and expenses for

the period. Actual results could differ from those estimates.

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Pzena Investment Management, Inc.

Notes to Unaudited Consolidated Financial Statements (Continued)

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 the applicable contractual terms. Advisory fee income also includes performance fees that may be earned by the Company depending on the investment return of the AUM. 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 March 31, 2016 and 2015, the Company recognized approximately \$0.1 million and \$0.4 million in performance fee income, respectively.

Cash and Cash Equivalents:

At March 31, 2016 and December 31, 2015, Cash and Cash Equivalents was \$20.5 million and \$35.4 million, respectively. 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 deposits and other accounts whose balances often 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:

At March 31, 2016 and December 31, 2015, the Company had \$3.4 million and \$3.6 million, respectively, of compensating balances recorded in Restricted Cash in the consolidated statements of financial condition.

Included in this balance at March 31, 2016 is a \$1.0 million letter of credit issued by a third party in lieu of a cash security deposit, as required by the Company’s lease for its corporate headquarters. At December 31, 2015 this balance included \$1.4 million in such letters of credit required by the Company's leases for both its current and former headquarters.

Also included in these balances at March 31, 2016 and December 31, 2015, were amounts of cash collateral for margin accounts established by the Pzena Long/Short Value Fund required to maintain to support securities sold short, not yet purchased of \$2.4 million and \$2.2 million, respectively.

Due to/from Broker:

Due to/from Broker consists primarily of amounts payable/receivable for unsettled securities transactions held/initiated at the clearing brokers of the Company’s consolidated subsidiaries.

Investments:

Investment Securities, trading

Investments classified as trading securities consist of equity securities held by the Company and its consolidated subsidiaries. Certain of the Company's investments are held to satisfy the Company's obligations under its deferred compensation program. Dividends associated with the Company's investments and the investments of the Company's consolidated subsidiaries are recorded as dividend income on an ex-dividend basis in the consolidated statement of operations.

Securities Sold Short represents securities sold short, not yet purchased by the Pzena Long/Short Value Fund, which is consolidated with the Company's financial statements. Dividend expense associated with these investments is reflected in Other Expense on an ex-dividend basis in the consolidated statements of operations.

All such investments are recorded at fair value, with net realized and unrealized gains and losses reported in earnings. Net realized and unrealized gains and losses are a component of Gains/ (Losses) and Other Investment Income in the consolidated statements of operations.

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Pzena Investment Management, Inc.

Notes to Unaudited Consolidated Financial Statements (Continued)

Investments in equity method investees

During the three months ended March 31, 2016, the Company accounted for its investments in certain private investment partnerships and the Pzena Emerging Markets Value Fund, in which the Company has non-controlling interests and exercises significant influence, using the equity method. These investments are included in Investments in the Company's consolidated statements of financial condition. The carrying value of these investment are recorded at the amount of capital reported by the private investment partnership. The capital account reflects any contributions paid to, distributions received from, and equity earnings of, the entities. The earnings of these investments are recorded as equity in the earnings of affiliates and reflected as a component of Gains/ (Losses) and Other Investment Income in the consolidated statements of operations.

Investments in equity method investees are evaluated for impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If the carrying amounts of the assets exceed their respective fair values, additional impairment tests are performed to measure the amounts of impairment losses, if any. During the three months ended March 31, 2016 and 2015, no impairment losses were recognized.

Fair Value Measurements:

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).

Included in the Company's consolidated statements of financial condition are investments in equity securities and securities sold short, both of which are exchange-traded securities with quoted prices in active markets. The fair value measurements of the equity securities, securities sold short, have been classified as Level 1. The investments in equity method investees are held at their carrying value.

As of December 31, 2015, the Company consolidated the Pzena Emerging Markets Value Fund which was deconsolidated upon the adoption of ASU 2015-02 as discussed above. As of December 31, 2015, included in the Company's consolidated statements of financial condition are investments in participatory notes ("P-notes") held by the Pzena Emerging Markets Value Fund. P-notes are generally issued by a bank or broker-dealer (the "counterparty") and are designed to offer a return linked to a particular underlying equity security, especially in markets where direct investments are not possible. The risks associated with investing in a P-note may include the possible failure of the counterparty to perform its obligations under the terms of the agreement, an inability to liquidate or transfer the notes, and an imperfect correlation between the value of the P-note and the underlying security. P-notes are valued based on the value of the underlying equity security and have been classified as Level 2.

The following table presents these instruments' fair value at March 31, 2016:

	Level 1	Level 2	Level 3	Other Assets Not Held at Fair Value	Total
	(in thousands)				
Assets:					
Equity Securities	\$13,417	\$—	\$—	\$—	\$13,417
Investments in Equity Method Investees	—	—	—	4,885	4,885
Total	\$13,417	\$—	\$—	\$4,885	\$18,302

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Pzena Investment Management, Inc.

Notes to Unaudited Consolidated Financial Statements (Continued)

	Level 1	Level 2	Level 3	Other Liabilities Not Held at Fair Value	Total
(in thousands)					
Liabilities:					
Securities Sold Short	\$2,555	\$	\$	\$	-\$2,555

The following table presents these instruments' fair value at December 31, 2015:

	Level 1	Level 2	Level 3	Other Assets Not Held at Fair Value	Total
(in thousands)					
Assets:					
Equity Securities	\$24,835	\$904	\$	\$—	\$25,739
Investments in Equity Method Investees	—	—	—	1,713	1,713
Total	\$24,835	\$904	\$	-\$1,713	\$27,452

	Level 1	Level 2	Level 3	Other Liabilities Not Held at Fair Value	Total
(in thousands)					
Liabilities:					
Securities Sold Short	\$2,231	\$	\$	\$	-\$2,231

For the three months ended March 31, 2016 and 2015, there were no transfers between levels. In addition, the Company did not hold any Level 2 securities during the three months ended March 31, 2016, nor any Level 3 securities during the three months ended March 31, 2016 and 2015.

Securities Valuation:

Investments in equity securities and securities sold short 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. Transactions are recorded on a trade date basis.

The net realized gain or loss on sales of equity securities and securities sold short is determined on a specific identification basis and is included in Gains/ (Losses) and Other Investment Income 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 cash equivalents in bank deposits and other accounts whose balances often 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, collections, and current credit conditions. For the three months ended March 31, 2016 and 2015, approximately 10.7% and 10.8% of the Company's advisory fees, respectively, were generated from advisory agreements with one client relationship. At March 31, 2016 and December 31, 2015, no allowance for doubtful accounts was deemed necessary.

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Pzena Investment Management, Inc.

Notes to Unaudited Consolidated Financial Statements (Continued)

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. The operating company has made a provision for New York City Unincorporated Business Tax ("UBT") and its consolidated subsidiary Pzena Investment Management, LTD has made a provision for U.K. income taxes.

Judgment is required in evaluating the Company's uncertain tax positions and determining its provision for income taxes. The Company establishes reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. These reserves are established when the Company believes that certain positions might be challenged despite its belief that its tax return positions are in accordance with applicable tax laws. The Company adjusts these reserves in light of changing facts and circumstances, such as the closing of a tax audit, new tax legislation or the change of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will affect the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the effect of reserve provisions and changes to reserves that are considered appropriate. It is also the Company's policy to recognize accrued interest, and penalties associated with uncertain tax positions in Income Tax Expense on the consolidated statements of operations. For the three months ended March 31, 2016 and 2015, no such expenses were recognized. As of March 31, 2016 and December 31, 2015, no such accruals were recorded.

The Company and its consolidated subsidiaries account for all U.S. federal, U.K., 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 carrying amount 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, 2016, the Company had a \$52.9 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, 2015, the Company had a \$54.0 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.

Excess tax benefits related to stock- and unit-transactions are not recognized until they result in a reduction of cash taxes payable. The benefit of these excess tax benefits will be recorded in equity when they reduce cash taxes payable. The Company will only recognize a tax benefit from stock- and unit-based awards in Additional Paid-In Capital if an incremental tax benefit is realized after all other tax benefits currently available have been utilized. For the three months ended March 31, 2015 the Company had \$0.1 million in tax benefits associated with stock- and unit-based awards that it was not able to recognize. For the three months ended March 31, 2016, the Company had no such benefits.

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Pzena Investment Management, Inc.

Notes to Unaudited Consolidated Financial Statements (Continued)

Foreign Currency:

The functional currency of the Company is the U.S. Dollar. Assets and liabilities of foreign operations whose functional currency is not the U.S. Dollar are translated at the exchange 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. A charge or credit is recorded to other comprehensive income to reflect the translation of these amounts to the extent the non-U.S. currency is designated the functional currency of the subsidiary. Non-functional currency related transaction gains and losses are immediately recorded in the consolidated statements of operations. For the three months ended March 31, 2016 the Company recorded less than \$0.1 million of other comprehensive income associated with foreign currency translation adjustments. For the three months ended March 31, 2015, the Company did not record any other comprehensive income.

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 fluctuations in foreign exchange rates on its non-U.S. investments. Such fluctuations are included in Gains/ (Losses) and Other Investment Income 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, foreign withholding taxes, and other receivables and payables recorded on the Company's books and the U.S. Dollar equivalent of the amounts actually received or paid. Net unrealized foreign exchange gains and losses arise from changes in the fair values of assets and liabilities resulting from changes in exchange rates.

Recently Issued Accounting Pronouncements Not Yet Adopted:

In March 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting". This update involves amendments related to several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The guidance is effective for the fiscal years and interim periods within those years beginning after December 15, 2016, and requires transition methods specific to each amendment in either a modified retrospective, retrospective, or prospective method. The Company is assessing the impact this standard will have on the consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)". This amended standard was written to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The new standard requires lessees to recognize a right-of-use asset and lease liability for all leases with terms of more than 12 months. Recognition, measurement and presentation of expenses will depend on classification as a finance or operating lease. The amendments also require certain quantitative and qualitative disclosure. Accounting guidance for lessors is largely unchanged. This guidance is effective for the fiscal years and interim periods within those years beginning after December 15, 2018, and requires a modified retrospective approach to adoption. The Company is assessing the impact

this standard will have on the consolidated financial statements and related disclosures.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." The core principle of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for the goods or services. In July 2015, the FASB postponed the effective date of this new guidance from January 1, 2017 to January 1, 2018. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is currently evaluating the potential impact on the consolidated statements and related disclosures, as well as the available transition methods.

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Pzena Investment Management, Inc.

Notes to Unaudited Consolidated Financial Statements (Continued)

Note 3—Compensation and Benefits

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

	For the Three Months Ended March 31, 2016 2015 (in thousands)	
Cash Compensation and Other Benefits	\$ 10,897	\$ 10,597
Non-Cash Compensation	1,601	1,473
Total Compensation and Benefits Expense	\$ 12,498	\$ 12,070

All non-cash compensation awards granted have varying vesting schedules and are issued at prices equal to the assessed fair market value at the time of issuance, as discussed below. Details of non-cash compensation awards granted during the three months ended March 31, 2016 and 2015 are as follows:

	For the Three Months Ended March 31, 2016 2015			
	Amount	Fair Value ¹	Amount	Fair Value ¹
Restricted Class B Units	5,812	\$ 8.60	23,782	\$ 9.46
Options to Purchase Shares of Class A Common Stock ²	—	\$ —	1,000,000	\$ 1.07
Deferred Compensation Phantom Delayed Exchange Class B Units ³	149,533	\$ 5.12	—	\$ —
Participating Shares of Restricted Class A Common Stock ⁴	—	\$ —	29,868	\$ 8.37
Restricted Shares of Class A Common Stock ⁵	—	\$ —	100,000	\$ 6.08

¹ Represents the grant date fair value per share or unit.

² Represents contingently vesting options to purchase shares of Class A common stock. These share options vest over a period of seven years contingent on meeting various performance goals.

³ Represents phantom Delayed Exchange Class B units issued under the Bonus Plan. These units vest ratably over four years and become Delayed Exchange Class B units upon vesting which may not be exchanged pursuant the Amended and Restated Operating Agreement until the seventh anniversary of the vesting date and are not entitled to any benefits under the Tax Receivable Agreement.

⁴ Represents restricted shares of Class A common stock that receive nonforfeitable rights to dividends.

⁵ Represents restricted shares of Class A common stock issued under the 2007 Equity Incentive Plan. These shares vest ratably over ten years and are not entitles to receive dividend or dividend equivalents until vested.

Pursuant to the Pzena Investment Management, LLC Amended and Restated 2006 Equity Incentive Plan (“the 2006 Equity Incentive Plan”), the operating company issues Class B units, phantom Class B units and options to purchase Class B units. The Company also issues Delayed Exchange Class B units pursuant to the 2006 Equity Incentive Plan. These Class B units vest immediately upon grant, but may not be exchanged pursuant to the Amended and Restated Operating Agreement of the operating company until at least the seventh anniversary of the date of grant. These units are also not entitled to any benefit under the Tax Receivable Agreement between the Company and members of the operating company. Under the Pzena Investment Management, Inc. 2007 Equity Incentive Plan (“the 2007 Equity Incentive Plan”), the Company issues shares of restricted Class A common stock and contingently vesting options to

acquire shares of Class A common stock. No restricted Class B units were forfeited during the three months ended March 31, 2016. During the three months ended March 31, 2015, 5,775 restricted Class B units were forfeited in connection with employee departures. During each of the three months ended March 31, 2016 and 2015, no contingently vesting options vested. During the three months ended March 31, 2016, 12,695 Delayed Exchange Class B units were issued for approximately \$0.1 million in cash to certain employee members. During the three months ended March 31, 2015, 142,315 Delayed Exchange Class B units issued to one employee during 2014 were canceled and replaced with cash compensation. Additional compensation expense of less than \$0.1 million was recognized upon cancellation and replacement of the award. No Class B units were canceled during the three months ended March 31, 2016.

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Pzena Investment Management, Inc.

Notes to Unaudited Consolidated Financial Statements (Continued)

Under the Pzena Investment Management, LLC Amended and Restated Bonus Plan (the “Bonus Plan”), eligible employees whose compensation is in excess of certain thresholds are required to defer a portion of that excess. These deferred amounts may be invested, at the employee’s discretion, in certain investment options designated by the Compensation Committee of the Company’s Board of Directors. Amounts deferred in any calendar year reduce that year’s compensation expense and are amortized and vest ratably over a four-year period commencing the following year. The Company also issued to certain of its employees deferred compensation with certain investment options that also vest ratably over a four-year period. As of March 31, 2016 and December 31, 2015, the liability associated with all deferred compensation investment accounts was \$0.9 million and \$2.9 million, respectively. During the three months ended March 31, 2016, approximately \$0.1 million in deferred compensation investments were forfeited in connection with employee departures. No deferred compensation was forfeited during the three months ended March 31, 2015.

Pursuant to the Pzena Investment Management, Inc. Non-Employee Director Deferred Compensation Plan (the “Director Plan”), non-employee directors may elect to have all or part of their compensation otherwise payable in cash, deferred in the form of phantom shares of Class A common stock of the Company issued under the 2007 Equity Incentive Plan. Elections to defer compensation under the Director Plan are made on a year-to-year basis. Distributions under the Director Plan are made in a single distribution of shares of Class A common stock at such time as elected by the participant when the deferral was made. Since inception of the Director Plan in 2009, the Company’s directors have elected to defer 100% of their compensation in the form of phantom shares of Class A common stock. Amounts deferred in any calendar year are amortized over the calendar year and reflected as General and Administrative Expense. As of March 31, 2016 and December 31, 2015, there were 288,191 and 232,585 phantom shares of Class A common stock outstanding, respectively. For the three months ended March 31, 2016 and 2015, no distributions were made under the Director Plan.

The Company has issued to certain of its employees delayed-vesting cash awards. For the three months ended March 31, 2016 and 2015 no such awards were granted. During the year ended December 31, 2015, \$0.4 million was paid in conjunction with previously awarded delayed-vesting cash awards with varying vesting schedules.

As of March 31, 2016 and December 31, 2015, the Company had approximately \$29.4 million and \$31.0 million, respectively, in unrecorded compensation expense related to unvested awards issued pursuant to its Bonus Plan and certain agreements; Class B units, Delayed Exchange Class B units, contingently vesting options, and phantom Class B units issued under the 2006 Equity Incentive Plan; and restricted Class A common stock and option grants issued under the 2007 Equity Incentive Plan. The Company anticipates that this unrecorded cost will amortize over the respective vesting periods of the awards.

Note 4 – Employee Benefit Plans

The operating company has a Profit Sharing and Savings Plan for the benefit of substantially all employees. The Profit Sharing and Savings Plan is a defined contribution profit sharing plan with a 401(k) deferral component.