
**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 September 30, 2010

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
(State or Other Jurisdiction of
Incorporation or Organization)

20-8999751
(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 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
(Do not check if a smaller reporting company)

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

As of November 4, 2010, there were 9,367,659 outstanding shares of the registrant's Class A common stock, par value \$0.01 per share.

As of November 4, 2010, there were 54,960,418 outstanding shares of the registrant's Class B common stock, par value \$0.000001 per share.

PZENA INVESTMENT MANAGEMENT, INC.
FORM 10-Q
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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,” “potential,” “predict,” “project,” or similar words or phrases, or the negatives of those words or phrases, may identify forward-looking statements, but the absence of these words does not necessarily mean that a statement is not forward-looking.

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

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

- our anticipated future results of operations and operating cash flows;
- our business strategies and investment policies;
- our financing plans and the availability of short- or long-term borrowing, or equity financing;
- our competitive position and the effects of competition on our business;
- potential growth opportunities available to us;
- the recruitment and retention of our employees;
- our expected levels of compensation for our employees;
- our potential operating performance, achievements, efficiency, and cost reduction efforts;
- our expected tax rate;
- changes in interest rates;
- our expectation with respect to the economy, capital markets, the market for asset management services, and other industry trends; and
- the impact of future legislation and regulation, and changes in existing legislation and regulation, on our business.

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

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, 2010 (unaudited)	December 31, 2009
ASSETS		
Cash and Cash Equivalents	\$ 26,801	\$ 15,908
Restricted Cash	1,420	1,407
Due from Broker	13	116
Advisory Fees Receivable	14,248	13,378
Investments, at Fair Value	3,058	7,951
Receivable from Related Parties	80	149
Other Receivables	53	36
Prepaid Expenses and Other Assets	637	504
Deferred Tax Asset, Net of Valuation Allowance of \$61,366 and \$60,252, respectively	7,554	6,754
Property and Equipment, Net of Accumulated Depreciation of \$2,686 and \$2,385, respectively	2,005	2,315
TOTAL ASSETS	\$ 55,869	\$ 48,518
LIABILITIES AND EQUITY		
Liabilities:		
Accounts Payable and Accrued Expenses	\$ 11,455	\$ 3,644
Due to Broker	16	731
Senior Subordinated Notes	—	10,000
Liability to Selling and Converting Shareholders	7,608	5,642
Other Liabilities	1,245	1,143
TOTAL LIABILITIES	20,324	21,160
Equity:		
Preferred Stock (Par Value \$0.01; 200,000,000 Shares Authorized; None Outstanding)	—	—
Class A Common Stock (Par Value \$0.01; 750,000,000 Shares Authorized; 9,367,659 and 8,633,041 Shares Issued and Outstanding in 2010 and 2009, respectively)	93	86
Class B Common Stock (Par Value \$0.000001; 750,000,000 Shares Authorized; 54,931,418 and 55,659,236 Shares Issued and Outstanding in 2010 and 2009, respectively)	—	—
Additional Paid-In Capital	10,689	10,104
Retained Earnings/(Accumulated Deficit)	194	(1,920)
Total Pzena Investment Management, Inc.'s Equity	10,976	8,270
Non-Controlling Interests	24,569	19,088
TOTAL EQUITY	35,545	27,358
TOTAL LIABILITIES AND EQUITY	\$ 55,869	\$ 48,518

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,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
REVENUE	\$ 18,482	\$ 16,813	\$ 57,020	\$ 44,717
EXPENSES				
Compensation and Benefits Expense	7,375	6,232	22,026	18,255
General and Administrative Expenses	1,837	1,904	5,927	6,330
TOTAL OPERATING EXPENSES	<u>9,212</u>	<u>8,136</u>	<u>27,953</u>	<u>24,585</u>
Operating Income	<u>9,270</u>	<u>8,677</u>	<u>29,067</u>	<u>20,132</u>
OTHER INCOME/(EXPENSE)				
Interest and Dividend Income	85	116	270	363
Interest Expense	—	(376)	(232)	(1,231)
Net Realized and Unrealized Gain from Investments	544	4,152	137	6,061
Increase in Liability to Selling and Converting Shareholders	(1,725)	(2,382)	(1,633)	(3,586)
Other Expense	3	41	72	149
Total Other Income/(Expense)	<u>(1,093)</u>	<u>1,551</u>	<u>(1,386)</u>	<u>1,756</u>
Income Before Income Taxes	<u>8,177</u>	<u>10,228</u>	<u>27,681</u>	<u>21,888</u>
Income Tax Provision/(Benefit)	(1,075)	(2,040)	1,373	(2,379)
Consolidated Net Income	<u>9,252</u>	<u>12,268</u>	<u>26,308</u>	<u>24,267</u>
Less: Net Income Attributable to Non-Controlling Interests	<u>8,033</u>	<u>10,836</u>	<u>23,632</u>	<u>21,531</u>
Net Income Attributable to Pzena Investment Management, Inc.	<u>\$ 1,219</u>	<u>\$ 1,432</u>	<u>\$ 2,676</u>	<u>\$ 2,736</u>
Net Income for Basic Earnings per Share	\$ 1,219	\$ 1,432	\$ 2,676	\$ 2,736
Basic Earnings per Share	\$ 0.13	\$ 0.17	\$ 0.29	\$ 0.34
Basic Weighted Average Shares Outstanding	9,367,659	8,633,041	9,125,477	8,077,545
Net Income for Diluted Earnings per Share	\$ 5,632	\$ 6,051	\$ 16,096	\$ 12,889
Diluted Earnings per Share	\$ 0.09	\$ 0.09	\$ 0.25	\$ 0.20
Diluted Weighted Average Shares Outstanding	64,993,746	64,994,278	65,006,198	64,756,331
Cash Dividends per Share of Class A Stock	\$ 0.03	\$ —	\$ 0.06	\$ —

See accompanying notes to consolidated financial statements.

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

	<u>For the Three Months Ended September 30,</u>		<u>For the Nine Months Ended September 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
OPERATING ACTIVITIES				
Consolidated Net Income	\$ 9,252	\$ 12,268	\$ 26,308	\$ 24,267
Adjustments to Reconcile Net Income to Cash Provided by Operating Activities:				
Depreciation	108	121	322	362
Non-Cash Compensation	901	255	2,565	816
Director Share Grant	14	—	41	280
Net Realized and Unrealized Gain from Investments	(544)	(4,152)	(137)	(6,061)
Increase in Liability to Selling and Converting Shareholders	1,725	2,382	1,633	3,586
Deferred Income Taxes	(1,677)	(2,611)	(579)	(3,804)
Changes in Operating Assets and Liabilities:				
Advisory Fees Receivable	(928)	(2,113)	(870)	881
Due from Broker	58	(19)	103	(13)
Prepaid Expenses and Other Assets	16	(1,550)	(120)	(1,544)
Due to Broker	(79)	(1)	(715)	(18)
Due to Principals	—	(653)	—	—
Accounts Payable, Accrued Expenses, and Other Liabilities	3,110	2,790	7,473	5,115
Purchases of Investments	(2,336)	(2,913)	(5,847)	(7,771)
Proceeds from Sale of Equity Securities	304	3,891	7,279	9,507
Net Cash Provided by Operating Activities	<u>9,924</u>	<u>7,695</u>	<u>37,456</u>	<u>25,603</u>
INVESTING ACTIVITIES				
Restricted Cash	(4)	—	(13)	—
Receivable from Related Parties	(13)	(43)	27	6
Purchases of Property and Equipment	(3)	—	(13)	(6)
Net Cash Provided by/(Used In) Investing Activities	<u>(20)</u>	<u>(43)</u>	<u>1</u>	<u>—</u>
FINANCING ACTIVITIES				
Distributions to Non-Controlling Interests	(6,322)	(4,719)	(20,225)	(12,199)
Contributions from Non-Controlling Interests	—	322	4,321	322
Retirement of B Units	—	—	(2)	—
Term Loan and Senior Subordinated Notes Repayment	—	(10,000)	(10,000)	(22,000)
Dividends	(281)	—	(562)	—
Net Cash Used in Financing Activities	<u>(6,603)</u>	<u>(14,397)</u>	<u>(26,468)</u>	<u>(33,877)</u>
NET CHANGE IN CASH	<u>\$ 3,301</u>	<u>\$ (6,745)</u>	<u>\$ 10,989</u>	<u>\$ (8,274)</u>
CASH AND CASH EQUIVALENTS - Beginning of Period	\$ 23,596	\$ 25,892	\$ 15,908	\$ 27,421
Effect of Deconsolidation of Affiliates	(96)	—	(96)	—
Net Change in Cash	3,301	(6,745)	10,989	(8,274)
CASH AND CASH EQUIVALENTS - End of Period	<u>\$ 26,801</u>	<u>\$ 19,147</u>	<u>\$ 26,801</u>	<u>\$ 19,147</u>
Supplementary Cash Flow Information:				
Interest Paid	\$ —	\$ 332	\$ 232	\$ 1,191
Income Taxes Paid	\$ 643	\$ 535	\$ 2,597	\$ 1,907

See accompanying notes to consolidated financial statements.

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, 2009	8,633,041	55,659,236	86	10,104	(1,920)	19,088	27,358
Unit Conversion	734,618	(734,618)	7	368	—	(318)	57
Retirement of Class B Units	—	(700)	—	—	—	(2)	(2)
Directors' Shares	—	—	—	4	—	37	41
Amortization of Non-Cash Compensation	—	7,000	—	276	—	1,679	1,955
Net Income	—	—	—	—	2,676	23,632	26,308
Contributions from Non-Controlling Interests	—	—	—	—	—	4,321	4,321
Distributions to Non-Controlling Interests	—	—	—	(63)	—	(20,162)	(20,225)
Effect of Deconsolidation of Affiliates	—	—	—	—	—	(3,706)	(3,706)
Class A Cash Dividends Paid (\$0.06 per share)	—	—	—	—	(562)	—	(562)
Balance at September 30, 2010	9,367,659	54,930,918	93	10,689	194	24,569	35,545

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

Pzena Investment Management, LLC is an investment adviser which is registered under the Investment Advisers Act of 1940 and is headquartered in New York, New York. As of September 30, 2010, the Company managed assets in a variety of value-oriented investment strategies across a wide range of market capitalizations in both U.S. and non-U.S. capital markets.

The Company, through its investment in its operating company, has consolidated the results of operations and financial condition of the following private investment partnership as of September 30, 2010:

<u>Entity</u>	<u>Type of Entity (Date of Formation)</u>	<u>Company’s Ownership at September 30, 2010</u>
Pzena Large Cap Value Fund	Massachusetts Trust (11/01/2002)	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 and variable-interest entities (“VIEs”) where the Company is deemed to be the primary beneficiary (“consolidated subsidiaries”). As required by the *Consolidation Topic* of the Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”), the Company also consolidates non-variable-interest entities in which it acts as the general partner or managing member. All of these entities represent private investment partnerships over which the Company exercises or exercised control. Non-controlling interests recorded on the consolidated financial statements of the Company include the non-controlling interests of the outside investors in each of these entities, as well as those of the operating company. All significant inter-company transactions and balances have been eliminated.

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

Effective December 31, 2009, substantially all of the Company’s investments in the Pzena Global Value Service and the Pzena EAFE Value Service, held to satisfy the Company’s obligations under its deferred compensation program, were reallocated to the Pzena Large Cap Value Fund. Also effective December 31, 2009, the investments of the operating company’s executive committee members in the Pzena Global Value Service and the Pzena EAFE Value Service were transferred to a separately-managed account. Since the remaining holders of the equity investments in the partnerships subsequent to these transactions lacked a controlling financial interest in these partnerships, as of December 31, 2009, these entities were deemed VIEs. The Company is not

Pzena Investment Management, Inc.
Unaudited Notes to the Consolidated Financial Statements (Continued)

considered the primary beneficiary of these entities. Correspondingly, the Pzena Global Value Service and the Pzena EAFE Value Service were deconsolidated effective December 31, 2009. The results of operations and financial position of each of these entities were consolidated up until December 30, 2009. The Pzena Global Value Service and the Pzena EAFE Value Service, and other 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 its EAFE Value strategies. The total net assets of these VIEs was approximately \$535.1 million and \$522.1 million at September 30, 2010 and December 31, 2009, respectively. The Company is not exposed to losses as a result of its involvement with these entities, since it has no direct investment in them.

During the three months ended June 30, 2010, the Company redeemed its investments in the Pzena Large Cap Value Fund, the Pzena Emerging Markets Focused Value Service, and the Pzena Emerging Market Countries Value Service. The operating company maintained its controlling financial interest as the managing member of these entities. Correspondingly, these entities were deemed VIEs. Since certain members of the operating company's executive committee were majority holders of the equity investments in the partnerships, the Company continued to be considered the primary beneficiary of these entities. As such, the results of operations and financial position of these entities were consolidated by the Company in accordance with the *Consolidation Topic* of the FASB ASC at June 30, 2010.

During the three months ended September 30, 2010, the holder of the equity investments in the Pzena Emerging Markets Focused Value Service and the Pzena Emerging Market Countries Value Service became the managing member of these entities. This appointment gave the holder of the equity investments a controlling financial interest in these entities. Correspondingly, the Company was no longer deemed to control these entities. Each of these limited liability companies is considered an entity "similar" to a limited partnership, and is subject to the guidance of the *Consolidation Topic* of the FASB ASC. As a result, the Pzena Emerging Markets Focused Value Service and the Pzena Emerging Market Countries Value Service were deconsolidated during the three months ended September 30, 2010.

The Company's investments previously held in the Pzena Large Cap Value Fund to satisfy the Company's obligations under its deferred compensation program have been transferred to third-party mutual funds and are included in investments in mutual funds at September 30, 2010.

The consolidated investment partnership, the Pzena Large Cap Value Fund, is an investment company under the American Institute of Certified Public Accountants Audit and Accounting Guide for Investment Companies. The Company has retained the specialized accounting for this partnership pursuant to the *Consolidation Topic* of the FASB ASC. Thus, the Company reports the investment partnership's investments in equity securities at fair value, with net realized and unrealized gains and losses reported in earnings in the consolidated statements of operations.

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

Management's Use of Estimates:

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

Fair Values of Financial Instruments:

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

Revenue Recognition:

Revenue, comprised of advisory fee income, is recognized over the period in which advisory services are provided. Advisory fee income includes management fees that are calculated based on percentages of assets under management ("AUM"), generally billed quarterly, either in arrears or advance, depending on their contractual terms. Advisory fee income also includes incentive fees that may be earned by the Company depending on the investment return of the AUM. Incentive fee arrangements generally entitle the Company to participate, on a fixed-percentage basis, in any returns generated in excess of an agreed-upon benchmark. The Company's

Pzena Investment Management, Inc.
Unaudited Notes to the Consolidated Financial Statements (Continued)

participation percentage in such return differentials is then multiplied by AUM to determine the incentive fees earned. In general, returns are calculated on an annualized basis over the contract's measurement period, which usually extends up to three years. Incentive fees are generally payable annually. Following the preferred method identified in the *Revenue Recognition Topic* of the FASB ASC, such incentive fee income is recorded at the conclusion of the contractual performance period, when all contingencies are resolved.

Earnings per Share:

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

For the three and nine months ended September 30, 2010 and 2009, the Company's diluted net income was determined as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Non-Controlling Interests of Pzena Investment Management, LLC	\$ 7,722	\$ 8,082	\$ 23,483	\$ 17,767
Less: Assumed Corporate Income Taxes	3,309	3,463	10,063	7,614
Assumed After-Tax Income of Pzena Investment Management, LLC	\$ 4,413	\$ 4,619	\$ 13,420	\$ 10,153
Assumed After-Tax Income of Pzena Investment Management, LLC	\$ 4,413	\$ 4,619	\$ 13,420	\$ 10,153
Net Income of Pzena Investment Management, Inc.	1,219	1,432	2,676	2,735
Diluted Net Income	\$ 5,632	\$ 6,051	\$ 16,096	\$ 12,888

For each of the three and nine months ended September 30, 2010, 1,620,060 options to purchase operating company units, 961,750 options to purchase Class A common stock, and 44,916 phantom operating company units were excluded from the calculation of diluted net income per share, as their inclusion would have had an antidilutive effect for each period. For each of the three and nine months ended September 30, 2009, 954,310 options to purchase operating company units were excluded from the calculation of diluted net income per share, as their inclusion also would have had an antidilutive effect.

Pzena Investment Management, Inc.
Unaudited Notes to the Consolidated Financial Statements (Continued)

For the three and nine months ended September 30, 2010 and 2009, 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,	
	2010	2009	2010	2009
	(in thousands, except share and per-share amounts)			
Net Income for Basic Earnings per Share	\$ 1,219	\$ 1,432	\$ 2,676	\$ 2,736
Basic Weighted Average Shares Outstanding	9,367,659	8,633,041	9,125,477	8,077,545
Basic Earnings per Share	\$ 0.13	\$ 0.17	\$ 0.29	\$ 0.34
Net Income for Diluted Earnings per Share	\$ 5,632	\$ 6,051	\$ 16,096	\$ 12,889
Dilutive Effect of Operating Company Class B Units	54,960,418	55,559,751	55,202,995	56,131,004
Dilutive Effect of Phantom Units	26,890	586,068	21,188	547,782
Dilutive Effect of Options	638,779	—	656,538	—
Diluted Weighted Average Shares Outstanding	64,993,746	64,994,278	65,006,198	64,756,331
Diluted Earnings per Share	\$ 0.09	\$ 0.09	\$ 0.25	\$ 0.20

Cash and Cash Equivalents:

At September 30, 2010, cash and cash equivalents was \$26.8 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 on the consolidated statements of operations.

Restricted Cash:

The Company maintains a compensating balance of \$1.4 million at September 30, 2010 as collateral for a letter of credit issued by a third party in lieu of a cash security deposit, as required by the Company's lease for its New York office space. Such amounts are recorded in restricted cash on the consolidated statements of financial condition.

Due to/from Broker:

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

Investments in Securities:

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

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

Pzena Investment Management, Inc.
Unaudited Notes to the Consolidated Financial Statements (Continued)

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

The following table presents these instruments' fair value at September 30, 2010:

	<u>Level 1</u>	<u>Level 2</u> (in thousands)	<u>Level 3</u>
Assets:			
Equity Securities	\$ 759	\$ —	\$ —
Investments in Mutual Funds	<u>2,299</u>	<u>—</u>	<u>—</u>
Total Fair Value	<u>\$ 3,058</u>	<u>\$ —</u>	<u>\$ —</u>

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

	<u>Level 1</u>	<u>Level 2</u> (in thousands)	<u>Level 3</u>
Assets:			
Equity Securities	\$ 7,951	\$ —	\$ —
Total Fair Value	<u>\$ 7,951</u>	<u>\$ —</u>	<u>\$ —</u>

Securities Valuation:

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

The net realized gain or loss on sales of securities is determined on a specific identification basis and is included in 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, 2010 and 2009, approximately 10.4% and 10.6%, respectively, of the Company's advisory fees were generated from an advisory agreement with one client. For the nine months ended September 30, 2010 and 2009, fees generated from this agreement comprised 10.1% and 11.4%, respectively, of the Company's total advisory fees. At September 30, 2010 and December 31, 2009, no allowance for doubtful accounts has been deemed necessary.

Financial Instruments:

On February 28, 2008, the operating company entered into an interest rate swap agreement, as discussed further in Note 9. This interest rate swap was subsequently unwound in conjunction with the termination of the credit agreement in September 2009. The counterparty to this agreement was a major financial institution. The Company's swap agreement was designated as a trading derivative and the fair value was recorded in other liabilities, with changes to the swap's fair value recognized as a component of other income/(expense). For each of the three and nine months ended September 30, 2009, the Company recognized less than \$0.1 million in other income related to such changes.

Pzena Investment Management, Inc.
Unaudited Notes to the Consolidated Financial Statements (Continued)

Pursuant to the guidance in the *Derivatives and Hedging Topic* of the FASB ASC, it is a requirement to disclose balance sheet and income statement amounts of derivatives, as well as their locations within the consolidated financial statements. The following table summarizes the impact of the Company's derivative financial instruments on its results of operations for the three and nine months ended September 30, 2009:

<u>Derivatives Not Accounted For As Hedging Instruments Under the Derivatives and Hedging Topic of the FASB ASC</u>	<u>Statement of Operations Account</u>	<u>Amount of Income Recognized in Income of Derivative</u>	
		<u>For the Three Months Ended September 30, 2009</u>	<u>For the Nine Months Ended September 30, 2009</u>
		(in thousands)	
Interest Rate Contracts	Other Income	\$ 20	\$ 88
Total		<u>\$ 20</u>	<u>\$ 88</u>

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, 2010, the Company had a \$61.4 million valuation allowance against the deferred tax asset recorded as part of the Company's initial public offering and the subsequent exchanges of Class B units for shares of its Class A common stock. At December 31, 2009, the Company had a \$60.3 million valuation allowance against this deferred tax asset. The income tax provision, or benefit, is the tax payable or refundable for the period, plus or minus the change during the period in deferred tax assets and liabilities. The Company records its deferred tax liabilities as a component of other liabilities on the consolidated statements of financial condition.

Foreign Currency:

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

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

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

Pzena Investment Management, Inc.
Unaudited Notes to the Consolidated Financial Statements (Continued)

from changes in exchange rates.

Recent Accounting Pronouncements:

In September 2009, the FASB issued a new standard that requires an enterprise to perform a qualitative analysis to determine whether its variable-interests give it a controlling financial interest in a VIE. Under the standard, an enterprise has a controlling financial interest when it has (a) the power to direct the activities of a VIE that most significantly impact the entity's economic performance, and (b) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. An enterprise that holds a substantive interest and a controlling financial interest in a VIE is deemed to be the primary beneficiary of the VIE and is required to consolidate the VIE. The standard also requires an ongoing assessment of whether an enterprise is the primary beneficiary of a VIE, and additional disclosures about an enterprise's involvement in VIEs, and any significant changes in risk exposure due to that involvement. The standard is effective for fiscal years beginning after November 15, 2009. In November 2009, the FASB issued a proposed standard update, which defers the consolidation criteria requirements of this new standard for assets managers' interests in entities that apply the specialized accounting guidance for investment companies, or that have the attributes of investment companies. In February 2010, the FASB issued further guidance which provided a limited scope deferral for a reporting entity's interest in an entity that meets all of the following conditions: (a) the entity has all the attributes of an investment company as defined under AICPA Audit and Accounting Guide, Investment Companies, or does not have all the attributes of an investment company but is an entity for which it is acceptable based on industry practice to apply measurement principles that are consistent with the AICPA Audit and Accounting Guide, Investment Companies, (b) the reporting entity does not have explicit or implicit obligations to fund any losses of the entity that could potentially be significant to the entity, and (c) the entity is not a securitization entity, asset-backed financing entity or an entity that was formerly considered a qualifying special-purpose entity. The reporting entity is required to perform a consolidation analysis for entities that qualify for the deferral in accordance with previously issued guidance on VIEs. The Company has evaluated the deferral guidelines and determined that the standard is applicable for the Company's investment in its operating company, but that the Company meets the criteria for deferral provided in this standard for its VIEs. The Company adopted the updated guidance on January 1, 2010, and it had no impact on the Company's consolidated financial statements. The Company is monitoring future guidance for updates on the treatment of its interests in its VIEs.

Note 3—Property and Equipment

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

	As of	
	September 30, 2010	December 31, 2009
	(in thousands)	
Leasehold Improvements	\$ 2,145	\$ 2,145
Furniture and Fixtures	1,164	1,163
Computer Hardware	930	948
Office Equipment	240	243
Computer Software	212	201
Total	4,691	4,700
Less: Accumulated Depreciation and Amortization	(2,686)	(2,385)
Total	\$ 2,005	\$ 2,315

Depreciation is included in general and administrative expenses and totaled \$0.1 million for each of the three months ended September 30, 2010 and 2009. Such expenses totaled \$0.3 million and \$0.4 million for the nine months ended September 30, 2010 and 2009, respectively.

Note 4—Related Party Transactions

For the three and nine months ended September 30, 2010, the Company earned \$1.4 million and \$4.1 million, respectively, in investment advisory fees from unconsolidated entities for which it acts as the investment manager. For the three and nine months ended September 30, 2009, such advisory fees totaled \$1.1 million and \$2.7 million, respectively.

Pzena Investment Management, Inc.
Unaudited Notes to the Consolidated Financial Statements (Continued)

At both September 30, 2010 and December 31, 2009, the Company had less than \$0.1 million remaining of an advance to an international investment company for organization and start-up costs, which is included in receivable from related parties on the consolidated statements of financial condition. The Company is the sponsor and investment manager of this entity.

At December 31, 2009, receivables from related parties included less than \$0.1 million of loans to employees. These loans were in the form of forgivable promissory notes, which were amortized through compensation expense pursuant to their terms. For the three months ended September 30, 2010, no amortization was recognized as compensation and benefits expense. For the three months ended September 30, 2009, and the three and nine months ended September 30, 2010, less than \$0.1 million of such amortization was recognized as compensation and benefits expense. At September 30, 2010, receivables from related parties included less than \$0.1 million of loans to employees.

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

On October 28, 2008, the Company issued an aggregate of \$16.0 million principal amount of Senior Subordinated Notes to entities established by Richard S. Pzena, the Company's Chief Executive Officer, for the benefit of certain of his family members, an entity controlled by a Company Director, and a former employee. On December 31, 2009, the Company repaid a total of \$6.0 million principal amount outstanding of Senior Subordinated Notes to the entity controlled by the Company Director and a former employee. During the nine months ended September 30, 2010, the Company repaid the remaining \$10.0 million principal amount outstanding of the Senior Subordinated Notes to the entities established by Richard S. Pzena.

Note 5—Commitments and Contingencies

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

The Company leases office space under a non-cancelable operating lease agreement which expires on October 31, 2015. The Company reflects minimum lease expense on a straight-line basis over the lease term. Lease expenses totaled \$0.4 million and \$0.5 million for the three months ended September 30, 2010 and 2009, respectively, and are included in general and administrative expenses. Such expenses totaled \$1.5 million and \$1.6 million for the nine months ended September 30, 2010 and 2009, respectively.

Note 6—Compensation and Benefits

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

	<u>For the Three Months</u> <u>Ended September 30,</u>		<u>For the Nine Months</u> <u>Ended September 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
	(in thousands)			
Cash Compensation and Other Benefits	\$ 6,474	\$ 5,977	\$ 19,461	\$ 17,439
Non-Cash Compensation	901	255	2,565	816
Total Compensation and Benefits Expense	<u>\$ 7,375</u>	<u>\$ 6,232</u>	<u>\$ 22,026</u>	<u>\$ 18,255</u>

For the three and nine months ended September 30, 2010 and 2009, the Company granted no options to purchase capital units of the operating company and no options to purchase shares of Class A common stock pursuant to its 2006 Plan and 2007 Plan.

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

Pzena Investment Management, Inc.
Unaudited Notes to the Consolidated Financial Statements (Continued)

ended September 30, 2010 and 2009. For the three months ended September 30, 2010 and 2009, no such options were granted.

Pursuant to the Pzena Investment Management, LLC Amended and Restated Bonus Plan (the "Bonus Plan"), which became effective January 1, 2007, eligible employees whose cash compensation is in excess of certain thresholds have a portion of that excess mandatorily deferred. Amounts deferred may take the form of phantom Class B units, or be invested in third-party funds at the employee's discretion, and vest ratably over four years. At both September 30, 2010 and December 31, 2009, the liability associated with deferred compensation investment accounts was approximately \$0.6 million, and has been included as a component of other liabilities on the consolidated statements of financial condition. For the three months ended September 30, 2010 and 2009, the Company recognized approximately \$0.4 million and \$0.3 million, respectively, in compensation and benefits expense associated with the amortization of all deferred compensation awards. For the nine months ended September 30, 2010 and 2009, the Company recognized approximately \$0.9 million and \$0.6 million, respectively, in such expense.

As of September 30, 2010 and December 31, 2009, the Company had approximately \$3.4 million and \$5.3 million, respectively, in unrecorded compensation expense related to unvested operating company phantom units issued pursuant to our deferred compensation plan, operating company Class B unit and option grants issued under the Company's 2006 Plan, and Class A stock option grants issued under our 2007 Plan.

Note 7—Short Term Borrowings

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

Note 8—Term Loan

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

Note 9—Interest Rate Swap

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

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

During 2009, the Company reduced the notional amount of its interest rate swap in tandem with the reductions in principal amounts outstanding under the credit agreement. The amounts paid to the counterparty in exchange for these reductions for the three and nine months ended September 30, 2009 were approximately \$0.2 million and \$0.5 million, respectively. For each of the three and nine months ended September 30, 2009, the Company recognized less than \$0.1 million in other expense associated with the change in fair value of the swap agreement.

Note 10—Income Taxes

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

Pzena Investment Management, Inc.
Unaudited Notes to the Consolidated Financial Statements (Continued)

The components of the income tax provision/(benefit) are as follows:

	<u>For the Three Months Ended September 30,</u>		<u>For the Nine Months Ended September 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
	(in thousands)			
Current Provision:				
Unincorporated Business Taxes	\$ 602	\$ 572	\$ 1,951	\$ 1,426
Local Corporate Tax	—	—	—	—
State Corporate Tax	—	—	—	—
Federal Corporate Tax	—	—	—	—
Total Current Provision	\$ 602	\$ 572	\$ 1,951	\$ 1,426
Deferred Provision:				
Unincorporated Business Taxes	\$ (56)	\$ (56)	\$ (168)	\$ (167)
Local Corporate Tax	60	57	176	121
State Corporate Tax	114	108	335	231
Federal Corporate Tax	391	372	1,152	793
Total Deferred Provision	\$ 509	\$ 481	\$ 1,495	\$ 978
Change in Valuation Allowance	(2,186)	(3,093)	(2,073)	(4,783)
Total Income Tax Provision/(Benefit)	\$ (1,075)	\$ (2,040)	\$ 1,373	\$ (2,379)

For the three and nine months ended September 30, 2010 and 2009, the Company's taxable income was determined as follows:

	<u>For the Three Months Ended September 30,</u>		<u>For the Nine Months Ended September 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
	(in thousands)			
Income Before Taxes	\$ 8,177	\$ 10,228	\$ 27,681	\$ 21,888
Unincorporated Business Taxes	(546)	(516)	(1,783)	(1,259)
Non-Controlling Interests	(8,033)	(10,836)	(23,632)	(21,531)
Income Before Corporate Income Taxes	\$ (402)	\$ (1,124)	\$ 2,266	\$ (902)

The *Income Taxes Topic* of the FASB ASC establishes the minimum threshold for recognizing, and a system for measuring, the benefits of tax return positions in financial statements. It is the Company's policy to recognize accrued interest, and penalties associated with uncertain tax positions, as part of the tax provision. For the three and nine months ended September 30, 2010 and 2009, no such expenses were recognized. As of September 30, 2010 and December 31, 2009, no such accruals were recorded.

The Company and the operating company are generally no longer subject to U.S. Federal or state and local income tax examinations by tax authorities for any year prior to 2007. All tax years subsequent to, and including, 2007 are considered open and subject to examination by tax authorities.

Prior to October 30, 2007, the operating company was a cash basis taxpayer. As a result of the Company's acquisition of Class B units in conjunction with the offering, the operating company was required to become an accrual basis taxpayer. Pursuant to Section 481 of the Internal Revenue Code, the cumulative difference between the two methods of taxpaying are amortizable over four years. These differences generated approximately \$0.1 million and \$0.2 million in deferred tax liabilities as of September 30, 2010 and December 31, 2009, respectively. Such amounts are recorded in other liabilities in the consolidated statements of financial condition.

Pzena Investment Management, Inc.
Unaudited Notes to the Consolidated Financial Statements (Continued)

The acquisition of the operating company Class B units noted above has allowed the Company to make an election under Section 754 of the Internal Revenue Code ("Section 754") to step up its tax basis in the net assets acquired. This step up is deductible for tax purposes over a 15-year period. Pursuant to a Tax Receivable Agreement signed between the members of the operating company and the Company, 85% of the cash savings generated by this election will be distributed to the selling and converting shareholders upon the realization of this benefit.

Based on the net proceeds of the offering and tax basis of the operating company as of October 30, 2007, this election gave rise to a deferred tax asset of approximately \$68.7 million. In December 2008, the Company established a \$62.7 million valuation allowance to reduce the net deferred tax asset to an amount more likely than not to be realized. This deferred tax asset remains available to the Company and can be used to reduce taxable income in future years. The Company similarly reduced the associated liability to selling and converting shareholders to reflect this change in the estimated realization of the asset.

As discussed further in Note 14, Shareholders' Equity, below, on March 31, 2010, and March 3, 2009, certain of the operating company's members exchanged an aggregate of 734,618 and 2,445,973, respectively, of their Class B units for an equivalent number of shares of Company Class A common stock. The Company elected to step up its tax basis in the incremental assets acquired in accordance with Section 754. Based on the exchange-date fair values of the Company's common stock and the tax basis of the operating company, this election gave rise to a \$3.6 million deferred tax asset and a corresponding \$3.0 million liability to converting shareholders on March 31, 2010, and a \$2.5 million deferred tax asset and a corresponding \$2.2 million liability to converting shareholders on March 3, 2009. The Company assessed the realizability of the deferred tax asset associated with each of these exchanges and determined that a portion of their benefits would go unutilized. Consequently, at March 31, 2010 and March 3, 2009, the Company established valuation allowances of \$3.2 million and \$2.4 million, respectively, to reduce the deferred tax asset to, an amount more likely than not to be realized, at each date. These deferred tax assets remain available to the Company and can be used to reduce taxable income in future years. The Company similarly reduced the associated liability to selling and converting shareholders by \$2.7 million and \$2.0 million at March 31, 2010 and March 3, 2009, respectively, to reflect this change in the estimated realization of the asset. As required by the *Income Taxes Topic* of the FASB ASC, the Company recorded the effects of these transactions in equity.

During the three months ended September 30, 2010 and 2009, the Company reduced its valuation allowance by approximately \$2.2 million and \$3.1 million, respectively, due to revised estimates of future taxable income. To reflect this change in the estimated realization of the asset, the Company correspondingly increased its liability to selling and converting shareholders by \$1.7 million and \$2.4 million for the three months ended September 30, 2010 and 2009, respectively. During the nine months ended September 30, 2010 and 2009, including the effects of the conversion discussed earlier, the Company's valuation allowance was reduced by approximately \$2.1 million and \$4.8 million, respectively, due to revised estimates of future taxable income. To reflect this change in the estimated realization of the asset, the Company correspondingly increased its liability to selling and converting shareholders by \$1.6 million and \$3.6 million for the nine months ended September 30, 2010 and 2009, respectively. The effects of these changes to the deferred tax asset and liability to selling and converting shareholders were recorded as a component of the income tax provision and other expense, respectively, on the consolidated statements of operations. As of September 30, 2010 and December 31, 2009, the net values of all deferred tax assets were approximately \$7.6 million and \$6.8 million, respectively.

As of September 30, 2010 and December 31, 2009, the net value of the liability to selling and converting shareholders was approximately \$7.6 million and \$5.6 million, respectively.

The change in the Company's net deferred tax assets for the three and nine months ended September 30, 2010 is summarized as follows:

Pzena Investment Management, Inc.
Unaudited Notes to the Consolidated Financial Statements (Continued)

	<u>Section 754</u>	<u>Other</u>	<u>Valuation Allowance</u>	<u>Total</u>
	(in thousands)			
Balance at December 31, 2009	\$ 65,006	\$ 2,001	\$ (60,253)	\$ 6,754
Deferred Tax Expense	(726)	173	—	(553)
Unit Conversion	3,577	—	(3,186)	391
Change in Valuation Allowance	—	—	1,266	1,266
Balance at March 31, 2010	<u>\$ 67,857</u>	<u>\$ 2,174</u>	<u>\$ (62,173)</u>	<u>\$ 7,858</u>
Deferred Tax Expense	(849)	303	—	(546)
Change in Valuation Allowance	—	—	(1,379)	(1,379)
Balance at June 30, 2010	<u>\$ 67,008</u>	<u>\$ 2,477</u>	<u>\$ (63,552)</u>	<u>\$ 5,933</u>
Deferred Tax Expense	(801)	236	—	(565)
Change in Valuation Allowance	—	—	2,186	2,186
Balance at September 30, 2010	<u>\$ 66,207</u>	<u>\$ 2,713</u>	<u>\$ (61,366)</u>	<u>\$ 7,554</u>

The change in the Company's net deferred tax assets for the three and nine months ended September 30, 2009 is summarized as follows:

	<u>Section 754</u>	<u>Other</u>	<u>Valuation Allowance</u>	<u>Total</u>
	(in thousands)			
Balance at December 31, 2008	\$ 65,368	\$ 785	\$ (62,709)	\$ 3,444
Deferred Tax Expense	(714)	512	—	(202)
Unit Conversion	2,532	—	(2,380)	152
Change in Valuation Allowance	—	—	814	814
Balance at March 31, 2009	<u>\$ 67,186</u>	<u>\$ 1,297</u>	<u>\$ (64,275)</u>	<u>\$ 4,208</u>
Deferred Tax Expense	(726)	320	—	(406)
Change in Valuation Allowance	—	—	876	876
Balance at June 30, 2009	<u>\$ 66,460</u>	<u>\$ 1,617</u>	<u>\$ (63,399)</u>	<u>\$ 4,678</u>
Deferred Tax Expense	(727)	190	—	(537)
Change in Valuation Allowance	—	—	3,093	3,093
Balance at September 30, 2009	<u>\$ 65,733</u>	<u>\$ 1,807</u>	<u>\$ (60,306)</u>	<u>\$ 7,234</u>

Note 11—Investments, at Fair Value

Investments consisted of the following at September 30, 2010:

	<u>Cost</u>	<u>Unrealized Gain</u>	<u>Fair Value</u>
	(in thousands)		
Investments	<u>\$ 2,777</u>	<u>\$ 281</u>	<u>\$ 3,058</u>

Investments consisted of the following at December 31, 2009:

	<u>Cost</u>	<u>Unrealized Gain</u>	<u>Fair Value</u>
	(in thousands)		
Investments	<u>\$ 7,321</u>	<u>\$ 630</u>	<u>\$ 7,951</u>

Pzena Investment Management, Inc.
Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 12—Non-Controlling Interests

Non-controlling interests in the operations of the Company's operating company and consolidated subsidiaries are comprised of the following:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Non-Controlling Interest of Pzena Investment Management, LLC	\$ 7,722	8,082	\$ 23,483	17,767
Non-Controlling Interest of Consolidated Subsidiaries	311	2,754	149	3,764
Non-Controlling Interests	\$ 8,033	\$ 10,836	\$ 23,632	\$ 21,531

Note 13—Members' Equity Interests of Operating Company

Except as otherwise provided by law, the liability of a member of the operating company is limited to the amount of its capital account. A member may transfer or assign all or any part of its membership interest with the prior written consent of Pzena Investment Management, Inc., which may be withheld at its sole discretion. Any transferee admitted as a member shall succeed to the capital account, or portion thereof, transferred or assigned, as if no such transfer or assignment had occurred.

Note 14—Shareholders' Equity

The Company was incorporated in the State of Delaware on May 8, 2007. On October 30, 2007, the Company consummated an initial public offering of shares of its Class A common stock, par value \$0.01 per share. These net proceeds were used to purchase Class B units of the operating company. Concurrently with the consummation of the Company's initial public offering, the operating agreement of the operating company was amended and restated such that, among other things, (i) the Company became the sole managing member of the operating company, (ii) the Class B units of the operating company that the Company acquired were reclassified as Class A units of the operating company, and (iii) the holders of the remaining outstanding Class B units of the operating company were reclassified as Class B units of the operating company. Class A and Class B units of the operating company have the same economic rights per unit. As of September 30, 2010, the holders of Class A common stock (through the Company) and the holders of Class B units of the operating company held approximately 14.6% and 85.4%, respectively, of the economic interests in the operations of the business. As of December 31, 2009, the holders of Class A common stock (through the Company) and the holders of Class B units of the operating company held approximately 13.4% and 86.6%, respectively, of the economic interests in the operations of the business.

Each holder of a Class B unit of the operating company is issued a corresponding share of the Company's Class B common stock, par value \$0.000001 per share, in exchange for payment of this par value. Each share of the Company's Class B common stock entitles its holder to five votes, until the first time that the number of shares of Class B common stock outstanding constitutes less than 20% of the number of all shares of the Company's common stock outstanding. From this time and thereafter, each share of the Company's Class B common stock entitles its holder to one vote. When a Class B unit is exchanged for a share of the Company's Class A common stock or forfeited, a corresponding share of the Company's Class B common stock will automatically be redeemed and cancelled. Conversely, to the extent that the Company causes the operating company to issue additional Class B units to employees pursuant to its equity incentive plan, these additional holders of Class B units would be entitled to receive a corresponding number of shares of the Company's Class B common stock (including if the Class B units awarded are subject to vesting).

All holders of the Company's Class B common stock have entered into a stockholders' agreement, pursuant to which they agreed to vote all shares of Class B common stock then held by them, and acquired in the future, together on all matters submitted to a vote of the common stockholders.

The outstanding shares of the Company's Class A common stock represent 100% of the rights of the holders of all classes of the Company's capital stock to receive distributions, except that holders of Class B common stock will have the right to receive the class's par value upon the Company's liquidation, dissolution or winding up.

Pursuant to the operating agreement of the operating company, each vested Class B unit is exchangeable for a share of the Company's Class A common stock, subject to certain exchange timing and volume limitations.

Pzena Investment Management, Inc.
Unaudited Notes to the Consolidated Financial Statements (Continued)

On March 31, 2010, and March 3, 2009, certain of the operating company's members exchanged an aggregate of 734,618 and 2,445,973, respectively, of their Class B units for an equivalent number of shares of Company Class A common stock. These acquisitions of additional operating company membership interests were treated as reorganizations of entities under common control as required by the *Business Combinations Topic* of the FASB ASC.

The incremental assets and liabilities assumed in the exchanges were recorded on March 31, 2010 and March 3, 2009 as follows:

	March 31, 2010	March 3, 2009
	(in thousands)	
Pzena Investment Management, LLC Members' Capital	\$ 10,140	\$ 33,788
Pzena Investment Management, LLC Accumulated Deficit	(9,824)	(33,679)
Realizable Deferred Tax Asset	391	152
Net Tax Receivable Liability to Converting Unitholders	(332)	(129)
Total	\$ 375	\$ 132
Common Stock, at Par	\$ 7	\$ 25
Additional Paid-in Capital	368	107
Total	\$ 375	\$ 132

Note 15—Subsequent Events

As required by the *Subsequent Events Topic* of the FASB ASC, the Company evaluated subsequent events through the issuance date of its consolidated financial statements.

On October 26, 2010, the Company's Board of Directors declared a quarterly dividend of \$0.03 per share of Class A common stock, payable on December 2, 2010 to shareholders of record as of November 18, 2010.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Overview

We are an investment management firm that utilizes a classic value investment approach in each of our investment strategies. We currently manage 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. At September 30, 2010, our assets under management, or AUM, was \$14.3 billion. We manage separate accounts on behalf of institutions and high net worth individuals and act as a sub-investment adviser for a variety of SEC-registered mutual funds and offshore funds.

We function as the holding company through which the business of our operating company, Pzena Investment Management, LLC, is conducted. Following our initial public offering and reorganization on October 30, 2007, we became the sole managing member of Pzena Investment Management, LLC. As such, we now control its business and affairs and, therefore, consolidate its financial results with ours. In light of our employees' and other investors' collective membership interest in our operating company, we reflect their ownership as a non-controlling interest in our consolidated financial statements. As a result, subsequent to October 30, 2007, our income is generated by our economic interest in our operating company's net income. As of September 30, 2010, the holders of Class A common stock (through the Company) and the holders of Class B units of the operating company held approximately 14.6% and 85.4%, respectively, of the economic interests in the operations of the business.

Revenue

We generate revenue primarily from management fees and incentive fees, which we collectively refer to as our advisory fees, by managing assets on behalf of institutional accounts and for retail clients, which are generally open-end mutual funds catering primarily to retail clients. Our advisory fee income is recognized over the period in which investment management services are provided. Following the preferred method identified in the *Revenue Recognition Topic* of the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC"), income from incentive fees is recorded at the conclusion of the contractual performance period, when all contingencies are resolved.

Our advisory fees are primarily driven by the level of our AUM. Our AUM increases or decreases with the net inflows or outflows of funds into our various investment strategies and with the investment performance thereof. In order to increase our AUM and expand our business, we must develop and market investment strategies that suit the investment needs of our target clients and provide attractive returns over the long term. The value and composition of our AUM, and our ability to continue to attract clients, will depend on a variety of factors including, among other things:

- our ability to educate our target clients about our classic value investment strategies and provide them with exceptional client service;
- the relative investment performance of our investment strategies, as compared to competing products and market indices;
- competitive conditions in the investment management and broader financial services sectors;
- general economic conditions;
- investor sentiment and confidence; and
- our decision to close strategies when we deem it to be in the best interests of our clients.

For our institutional accounts, we are paid fees according to a schedule, which varies by investment strategy. The substantial majority of these accounts pay us management fees pursuant to a schedule in which the rate we earn on the AUM declines as the amount of AUM increases. Certain of these clients pay us fees according to the performance of their accounts relative to certain agreed-upon benchmarks, which results in a slightly lower base fee, but allows us to earn higher fees if the relevant investment strategy outperforms the agreed-upon benchmark.

Pursuant to our sub-investment advisory agreements with our retail clients, we are generally paid a management fee according to a schedule in which the rate we earn on the AUM declines as the amount of AUM increases. Certain of these funds pay us fixed rate management fees. Due to the substantially larger account size of certain of these accounts, the average advisory fees we earn on them, as a percentage of AUM, are lower than the advisory fees we earn on our institutional accounts.

The majority of advisory fees we earn on institutional accounts are based on the value of AUM at a specific date on a quarterly basis, either in arrears or advance. Generally, advisory fees on certain of our institutional accounts, and with respect to most of our retail accounts, are calculated based on the average of the monthly or daily market values. Advisory fees are generally adjusted for any cash flows into or out of a portfolio, where the cash flow represents greater than 10% of the value of the portfolio. While a specific group of accounts may use the same fee rate, the method used to calculate the fee according to the fee rate schedule may differ as described above.

Our advisory fees may fluctuate based on a number of factors, including the following:

- changes in AUM due to appreciation or depreciation of our investment portfolios, and the levels of the contribution and withdrawal of assets by new and existing clients;
- distribution of AUM among our investment strategies, which have different fee schedules;
- distribution of AUM between institutional accounts and retail accounts, for which we generally earn lower overall advisory fees; and
- the level of our performance with respect to accounts on which we are paid incentive fees.

Expenses

Our expenses consist primarily of compensation and benefits expenses, as well as general and administrative expenses. These expenses may fluctuate due to a number of factors, including the following:

- variations in the level of total compensation expense due to, among other things, bonuses, awards of equity to our employees and members of our operating company, changes in our employee count and mix, and competitive factors; and
- expenses, such as rent, professional service fees and data-related costs, incurred, as necessary, to run our business.

Compensation and Benefits Expense

Our largest expense is compensation and benefits, which includes the salaries, bonuses, equity-based compensation and related benefits and payroll costs attributable to our members and employees. Compensation and benefits packages are benchmarked against relevant industry and geographic peer groups in order to attract and retain qualified personnel. The table included in the section below describes the components of our compensation expense for the three and nine months ended September 30, 2010 and 2009:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Cash Compensation and Other Benefits	\$ 6,474	\$ 5,977	\$ 19,461	\$ 17,439
Other Non-Cash Compensation	901	255	2,565	816
Total Compensation and Benefits Expense	\$ 7,375	\$ 6,232	\$ 22,026	\$ 18,255

Pursuant to the Pzena Investment Management, LLC 2006 Equity Incentive Plan (the “2006 Plan”) and the Pzena Investment Management, Inc. 2007 Equity Incentive Plan (“the 2007 Plan,” together the “2006 and 2007 Plans”), we have issued restricted Class B units and options to acquire Class B units in our operating company, and options to acquire shares of our Class A common stock, all of which vest ratably over the respective award’s vesting period. We used a fair-value method in recording the compensation expense associated with the granting of these stock-based compensation awards. Under this method, compensation expense is measured at the grant date based on the estimated fair value of the award and is recognized over the award’s vesting period. The fair value of the units is determined by reference to the market price of our Class A common stock on the date of grant, since these units are exchangeable for shares of our Class A common stock on a one-for-one basis. The fair value of the options to acquire Class B units and options to acquire shares of our Class A common stock is determined by using an appropriate option pricing model on the grant date.

On January 1, 2007, we instituted a deferred compensation plan, in which employees who earn in excess of \$600,000 per year are required to defer a portion of their compensation in excess of this amount. These deferred amounts may take the form of phantom Class B units, or be invested in a variety of third-party mutual funds at the employee's discretion, and vest ratably over four years. Amounts deferred in any period reduce that period's cash compensation expense and vest ratably over a four-year period beginning on January 1 of the next year. Should additional amounts be deferred in future periods, we would expect the non-cash portion of our compensation expense to increase as the existing and subsequently deferred amounts are amortized through income.

As of September 30, 2010, we had approximately \$3.4 million in unrecorded compensation expense related to unvested operating company phantom units issued pursuant to our deferred compensation plan, operating company Class B unit and option grants issued under our 2006 Plan, and Class A stock and option grants issued under our 2007 Plan. We expect that the amortization of these amounts will be approximately \$0.7 million for the remainder of 2010, \$2.6 million for 2011, and \$0.1 million for 2012, with a negligible amount amortized thereafter.

General and Administrative Expenses

General and administrative expenses include professional and outside services fees, office expenses, depreciation and the costs associated with operating and maintaining our research, trading and portfolio accounting systems. Our occupancy-related costs and professional services expenses, in particular, generally increase or decrease in relative proportion to the overall size and scale of our business operations.

As a result of our offering on October 30, 2007, we have incurred, and expect to continue to incur, additional expenses associated with being a public company for, among other things, director and officer insurance, director fees, SEC reporting and compliance (including Sarbanes-Oxley compliance), professional fees, transfer agent fees, and other similar expenses. These additional expenses have and will continue to reduce our net income.

Other Income/(Expense)

Other income/(expense) is derived primarily from changes in our estimates of the liability due to our selling and converting shareholders associated with payments owed to them under the tax receivable agreement which was executed in connection with our reorganization and offering on October 30, 2007. As discussed further below, under "Tax Receivable Agreement," this liability represents 85% of the amount of cash savings, if any, in U.S. federal, state, and local income tax that we realize as a result of the amortization of the increases in tax basis generated from the Company's acquisitions of operating company units from its selling and converting shareholders. Amounts waived by our selling and converting shareholders have, and would, reduce this liability. Other income/(expense) is also affected by the investment income or loss which arose from our investments in various private investment vehicles that we employed to incubate new strategies prior to their redemption during the three months ended September 30, 2010, the non-controlling interest allocation of the income or loss of our consolidated investment partnerships to their outside investors, interest expense on our outstanding debt prior to its extinguishment, mark-to-market movements on our swap agreement prior to its termination, net realized and unrealized gains and losses from our investments in mutual funds, and interest income generated on our excess cash balances. We expect the interest and investment components, if any, of other income/(expense), in the aggregate, to fluctuate based on market conditions.

Non-Controlling Interests

Our operating company has historically consolidated the results of operations of the private investment partnerships over which we exercise a controlling influence. After our reorganization, we became the sole managing member of our operating company and now control its business and affairs and, therefore, consolidate its financial results with ours. In light of our employees' and outside investors' interest in our operating company, we have reflected their membership interests as a non-controlling interest in our consolidated financial statements. As a result, subsequent to October 30, 2007, our income is generated by our economic interest in our operating company's net income. As of September 30, 2010, the holders of Class A common stock (through the Company) and the holders of Class B units of the operating company held approximately 14.6% and 85.4%, respectively, of the economic interests in the operations of the business.

Income Tax Provision/(Benefit)

While our operating company has historically not been subject to U.S. federal and certain state income taxes, it has been subject to New York City Unincorporated Business Tax. As a result of our reorganization, we are subject to taxes applicable to C-corporations. As such, our effective tax rate has increased as a result of our reorganization. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount more likely than not to be realized. As of September 30, 2010 and December 31, 2009, the Company's valuation allowance against the deferred tax asset associated with our acquisition of operating company units in conjunction with the offering and subsequent exchanges was \$61.4 million and \$60.3 million, respectively.

Operating Results

General

Our earnings and cash flows are heavily dependent upon prevailing financial market conditions. Significant increases or decreases in the various securities markets, particularly the equities markets, can have a material impact on our results of operations, financial condition, and cash flows.

Beginning in the second half of 2007 and continuing through the quarter ended March 31, 2009, the performance of our investment strategies was negatively impacted by significant volatility in the equity markets. Performance prior to March 31, 2009 was influenced by our overweight investment exposure to the financial services sector in particular. Subsequent to March 31, 2009, all of our investment strategies experienced improvement in their performance, and outperformed their respective benchmarks. As a result, our assets under management increased by \$0.4 billion, or 2.9%, from \$13.9 billion at September 30, 2009, to \$14.3 billion at September 30, 2010, due to positive performance of \$0.9 billion, offset by net outflows of \$0.5 billion.

For the three months ended September 30, 2010, we experienced net outflows of \$0.3 billion, consisting of gross outflows of \$1.2 billion, offset by gross inflows of \$0.9 billion. For the nine months ended September 30, 2010, we experienced net outflows of \$0.7 billion, consisting of gross outflows of \$3.0 billion, offset by gross inflows of \$2.3 billion.

For the three months ended September 30, 2010, our institutional accounts experienced gross inflows of \$0.6 billion, which were offset by \$0.5 billion in gross outflows. For the nine months ended September 30, 2010, our institutional accounts experienced gross inflows of \$1.3 billion, which were offset by \$1.3 billion in gross outflows.

For the three months ended September 30, 2010, our retail accounts experienced \$0.7 billion in gross outflows and \$0.3 billion in gross inflows. For the nine months ended September 30, 2010, our retail accounts experienced \$1.7 billion in gross outflows and \$1.0 billion in gross inflows.

Our average AUM fluctuates based on changes in the market value of accounts advised and managed by us, and on fund flows. Accordingly, given our higher average AUM levels, our revenues for the three and nine months ended September 30, 2010 increased compared to our revenues for the three and nine months ended September 30, 2009. An increase in revenue typically results in higher operating income and net income.

Assets Under Management and Flows

The change in AUM in our institutional accounts and our retail accounts for the three and nine months ended September 30, 2010 and 2009 and the twelve months ended September 30, 2010 is described below:

Assets Under Management	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		For the Twelve Months Ended September 30,
	2010	2009	2010	2009	2010
	(in billions)				
Institutional Accounts					
Beginning of Period Assets	\$10.0	\$7.5	\$10.7	\$7.4	\$10.2
Inflows	0.6	0.9	1.3	1.8	2.2
Outflows	(0.5)	(0.3)	(1.3)	(1.5)	(1.8)
Net Flows	0.1	0.6	0.0	0.3	0.4
Market Appreciation	1.2	2.1	0.6	2.5	0.7
End of Period Assets	<u>\$11.3</u>	<u>\$10.2</u>	<u>\$11.3</u>	<u>\$10.2</u>	<u>\$11.3</u>
Retail Accounts					
Beginning of Period Assets	\$3.1	\$3.1	\$3.6	\$3.3	\$3.7
Inflows	0.3	0.3	1.0	0.9	1.5
Outflows	(0.7)	(0.4)	(1.7)	(1.5)	(2.4)
Net Flows	(0.4)	(0.1)	(0.7)	(0.6)	(0.9)
Market Appreciation	0.3	0.7	0.1	1.0	0.2
End of Period Assets	<u>\$3.0</u>	<u>\$3.7</u>	<u>\$3.0</u>	<u>\$3.7</u>	<u>\$3.0</u>
Total					
Beginning of Period Assets	\$13.1	\$10.6	\$14.3	\$10.7	\$13.9
Inflows	0.9	1.2	2.3	2.7	3.7
Outflows	(1.2)	(0.7)	(3.0)	(3.0)	(4.2)
Net Flows	(0.3)	0.5	(0.7)	(0.3)	(0.5)
Market Appreciation	1.5	2.8	0.7	3.5	0.9
End of Period Assets	<u>\$14.3</u>	<u>\$13.9</u>	<u>\$14.3</u>	<u>\$13.9</u>	<u>\$14.3</u>

At September 30, 2010, our \$14.3 billion of AUM was invested in various value-oriented investment strategies representing distinct geographical segments. The following table describes the allocation of our AUM, as of September 30, 2010 and 2009, among our investment strategies:

Investment Strategy	AUM at September 30,	
	2010	2009
	(in billions)	
U.S. Value Strategies	\$ 9.2	\$ 9.9
Global Value Strategies	3.2	2.4
Europe, Australasia, and Far East ("EAFE") Value Strategies	1.9	1.6
Total	<u>\$ 14.3</u>	<u>\$ 13.9</u>

Three Months Ended September 30, 2010 versus September 30, 2009

At September 30, 2010, we managed \$14.3 billion in total assets, an increase of \$0.4 billion, or 2.9%, from \$13.9 billion at September 30, 2009. The year-over-year increase in AUM was primarily due to \$0.9 billion in market appreciation and \$3.7 million in gross inflows, offset by \$4.2 billion in gross outflows. Improving overall economic conditions contributed to the performance-related increase in our AUM.

At September 30, 2010, we managed \$11.3 billion in institutional accounts and \$3.0 billion in retail accounts, for a total of \$14.3 billion in assets. For the three months ended September 30, 2010, assets in institutional accounts increased by \$1.3 billion, or 13.0%, due to \$1.2 billion in market appreciation and \$0.6 billion in gross inflows, offset by \$0.5 billion in gross outflows. For the three months ended September 30, 2010, assets in retail accounts decreased by \$0.1 billion, or 3.2%, as a result of \$0.7 billion in gross outflows, offset by \$0.3 billion in gross inflows and \$0.3 billion in market appreciation.

Nine Months Ended September 30, 2010 versus September 30, 2009

At September 30, 2010, we managed \$14.3 billion in total assets, an increase of \$0.4 billion, or 2.9%, from \$13.9 billion at September 30, 2009. The year-over-year increase in AUM was primarily due to \$0.9 billion in market appreciation and \$3.7 billion in gross inflows, offset by \$4.2 billion in gross outflows. Improving overall economic conditions contributed to the performance-related increase in our AUM.

At September 30, 2010, we managed \$11.3 billion in institutional accounts and \$3.0 billion in retail accounts, for a total of \$14.3 billion in assets. For the nine months ended September 30, 2010, assets in institutional accounts increased by \$0.6 billion, or 5.6%, due to \$0.6 billion in market appreciation and \$1.3 billion in gross inflows, offset by \$1.3 billion in gross outflows. For the nine months ended September 30, 2010, assets in retail accounts decreased by \$0.6 billion, or 16.7%, as a result of \$1.7 billion in gross outflows, offset by \$1.0 billion in gross inflows and \$0.1 billion in market appreciation.

At September 30, 2010, institutional accounts represented 79.0% of our total AUM, compared to 73.4% at September 30, 2009. At September 30, 2010, our Global Value and EAFE Value investment strategies accounted for 35.7% of our AUM, compared to 28.8% at September 30, 2009.

Revenues

Our revenues from advisory fees earned on our institutional and retail accounts for the three and nine months ended September 30, 2010 and 2009 is described below:

Revenue	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Institutional Accounts	\$ 15,491	\$ 13,839	\$ 47,756	\$ 36,466
Retail Accounts	2,991	2,974	9,264	8,251
Total	<u>\$ 18,482</u>	<u>\$ 16,813</u>	<u>\$ 57,020</u>	<u>\$ 44,717</u>

Three Months Ended September 30, 2010 versus September 30, 2009

Our total revenue increased \$1.7 million, or 10.1%, to \$18.5 million for the three months ended September 30, 2010, from \$16.8 million for the three months ended September 30, 2009. This change was driven primarily by an increase in weighted average AUM, which increased \$1.4 billion, or 11.5%, to \$13.6 billion for the three months ended September 30, 2010, from \$12.2 billion for the three months ended September 30, 2009.

Our weighted average fee rate was 0.544% and 0.550% for the three months ended September 30, 2010 and 2009, respectively. The decrease in the weighted average fee rate was due in part to large institutional inflows in our newly launched Europe, Australasia, and Far East (“EAFE”) Diversified Value and Global Diversified Value strategies in the fourth quarter of 2009. We typically offer reduced fee rates to initial clients in our new product offerings. The decrease in the weighted average fee rate was also due to an increase in the average size of our institutional accounts. Our tiered fee schedules typically charge lower rates as account size increases. Weighted average assets in institutional accounts increased \$1.7 billion, or 19.3%, to \$10.5 billion for the three months ended September 30, 2010, from \$8.8 billion for the three months ended September 30, 2009, and had a weighted average fee rate of 0.589% and 0.630% for the three months ended September 30, 2010 and 2009, respectively. This decline was primarily due to institutional inflows in our EAFE Diversified Value and Global Diversified Value strategies, and a higher average institutional account size. Weighted average assets in retail accounts decreased \$0.3 billion, or 8.8%, to \$3.1 billion for the three months ended September 30, 2010, from \$3.4 billion for the three months ended September 30, 2009, and had a weighted average fee rate of 0.389% and 0.346% for the three months ended September 30, 2010 and 2009, respectively. The year-over-year increase was due to the timing of asset flows in our retail accounts and the expiration of the voluntary partial fee waiver on the John Hancock Classic Value Fund, for which we act as sub-investment advisor, which ended in May 2010.

Nine Months Ended September 30, 2010 versus September 30, 2009

Our total revenue increased \$12.3 million, or 27.5%, to \$57.0 million for the nine months ended September 30, 2010, from \$44.7 million for the nine months ended September 30, 2009. This change was driven primarily by an increase in weighted average AUM, which increased \$3.5 billion, or 32.7%, to \$14.2 billion for the nine months ended September 30, 2010, from \$10.7 billion for the nine months ended September 30, 2009.

Our weighted average fee rate was 0.537% and 0.559% for the nine months ended September 30, 2010 and 2009, respectively. The decrease in the weighted average fee rate was due primarily to an increase in the average size of our institutional accounts. Our tiered fee schedules typically charge lower rates as account size increases. Weighted average assets in institutional accounts increased \$3.2 billion, or 42.1%, to \$10.8 billion for the nine months ended September 30, 2010, from \$7.6 billion for the nine months ended September 30, 2009, and had a weighted average fee rate of 0.590% and 0.642% for the nine months ended September 30, 2010 and 2009, respectively. Weighted average assets in retail accounts increased \$0.3 billion, or 9.7%, to \$3.4 billion for the nine months ended September 30, 2010, from \$3.1 billion for the nine months ended September 30, 2009, and had a weighted average fee rate of 0.367% and 0.355% for the nine months ended September 30, 2010 and 2009, respectively. The year-over-year increase in weighted average fee rate for retail assets was due to the timing of asset flows in our retail accounts and the effects of the voluntary partial fee waiver on the John Hancock Classic Value Fund, for which we act as sub-investment advisor, which commenced in May 2009 and expired in May 2010.

Expenses

Our operating expenses are driven primarily by our compensation costs. The table below describes the components of our compensation expense for the three and nine months ended September 30, 2010 and 2009:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Cash Compensation and Other Benefits	\$ 6,474	\$ 5,977	\$ 19,461	\$ 17,439
Other Non-Cash Compensation	901	255	2,565	816
Total Compensation and Benefits Expense	<u>\$ 7,375</u>	<u>\$ 6,232</u>	<u>\$ 22,026</u>	<u>\$ 18,255</u>

Three Months Ended September 30, 2010 versus September 30, 2009

Total operating expenses increased by \$1.1 million, or 13.6%, to \$9.2 million for the three months ended September 30, 2010, from \$8.1 million for the three months ended September 30, 2009. This increase was primarily attributable to increases in discretionary bonus accruals and employee headcount, which increased from 65 at September 30, 2009 to 71 at September 30, 2010.

Compensation and benefits expense increased by \$1.2 million, or 19.4%, to \$7.4 million for the three months ended September 30, 2010, from \$6.2 million for the three months ended September 30, 2009. This increase was primarily a result of increases in discretionary bonus accruals and employee headcount, which increased from 65 at September 30, 2009 to 71 at September 30, 2010, as discussed above.

General and administrative expenses decreased by \$0.1 million, or 5.3%, to \$1.8 million for the three months ended September 30, 2010, from \$1.9 million for the three months ended September 30, 2009. This decrease was mainly attributable to decreases in insurance fees.

Nine Months Ended September 30, 2010 versus September 30, 2009

Total operating expenses increased by \$3.4 million, or 13.8%, to \$28.0 million for the nine months ended September 30, 2010, from \$24.6 million for the nine months ended September 30, 2009. This increase was primarily attributable to increases in discretionary bonus accruals and employee headcount, which increased from 65 at September 30, 2009 to 71 at September 30, 2010.

Compensation and benefits expense increased by \$3.7 million, or 20.2%, to \$22.0 million for the nine months ended September 30, 2010, from \$18.3 million for the nine months ended September 30, 2009. This increase was primarily a result of increases in discretionary bonus accruals and employee headcount, which increased from 65 at September 30, 2009 to 71 at September 30, 2010, as discussed above.

General and administrative expenses decreased by \$0.4 million, or 6.3%, to \$5.9 million for the nine months ended September 30, 2010, from \$6.3 million for the nine months ended September 30, 2009. This decrease was mainly attributable to decreases in professional fees and insurance fees.

Other Income/(Expense)

Three Months Ended September 30, 2010 versus September 30, 2009

Other income/(expense) was an expense of \$1.1 million for the three months ended September 30, 2010. Exclusive of \$1.7 million in other expense associated with a decrease in our liability to our selling and converting shareholders associated with changes in the realizability of our related deferred tax asset, other income/(expense) was income of \$0.6 million. This income consisted primarily of \$0.5 million in unrealized and realized gains and losses from investments. Net realized and unrealized gain/(loss) from investments represents both the Company's and external investors' allocation of the gain/(loss) from the Company's consolidated investments. At September 30, 2010, the Company had total assets of \$0.8 million in such investments. Of the net realized and unrealized gain/(loss) from investments for the three months ended September 30, 2010, \$0.3 million was attributable to the outside interests of our investment partnerships. The external investors' allocation of net realized and unrealized gain/(loss) is also included as a component of net income from non-controlling interests. Interest and dividend income was income of \$0.1 million.

Other income/(expense) was income of \$1.6 million for the three months ended September 30, 2009. Exclusive of \$2.4 million in other expense associated with an increase in our liability to our selling and converting shareholders associated with changes in the realizability of our related deferred tax asset, other income/(expense) was income of \$4.0 million. This income consisted primarily of \$4.2 million in income related to the positive performance of investments in our own products, offset by \$0.2 million in net interest expense. Net realized and unrealized gain/(loss) from investments represents both the Company's and external investors' allocation of the gain/(loss) from the Company's consolidated investments. At September 30, 2009, the Company had total assets of \$18.4 million in such investments. Of the \$4.2 million in income related to the positive performance of our investments in our own products, \$2.8 million was attributable to the outside interests of our investment partnerships. The external investors' allocation of net realized and unrealized gain/(loss) is also included as a component of net income from non-controlling interests.

Nine Months Ended September 30, 2010 versus September 30, 2009

Other income/(expense) was an expense of \$1.4 million for the nine months ended September 30, 2010. Exclusive of \$1.6 million in other expense associated with an increase in our liability to our selling and converting shareholders associated with changes in the realizability of our related deferred tax asset, other income/(expense) was income of \$0.2 million. This income consisted primarily of \$0.1 million in miscellaneous income and \$0.1 million in income related to the positive performance of our investments in our own products, all of which was attributable to the outside interests of our investment partnerships. At September 30, 2010, the Company had total assets of \$0.8 million in such investments. The external investors' allocation of net realized and unrealized gain/(loss) is also included as a component of net income from non-controlling interests.

Other income/(expense) was income of \$1.8 million for the nine months ended September 30, 2009. Exclusive of \$3.6 million in other expense associated with an increase in our liability to our selling and converting shareholders associated with changes in the realizability of our related deferred tax, other income/(expense) was income of \$5.4 million. This income consisted primarily of \$6.1 million in income related to the positive performance of our investments in our own products and \$0.2 million in miscellaneous income, offset by \$0.9 million in net interest expense. Net realized and unrealized gain/(loss) from investments represents both the Company's and external investors' allocation of the gain/(loss) from the Company's consolidated investments. At September 30, 2009, the Company had total assets of \$18.4 million in such investments. Of the \$6.1 million in income related to the positive performance of our investments in our own products, \$3.8 million was attributable to the outside interests of our investment partnerships. The external investors' allocation of net realized and unrealized gain/(loss) is also included as a component of net income from non-controlling interests.

Income Tax Provision/(Benefit)

Three Months Ended September 30, 2010 versus September 30, 2009

The income tax provision/(benefit) was a benefit of \$1.1 million for the three months ended September 30, 2010. This benefit was generated primarily due to a \$2.2 million reduction of the valuation allowance against our deferred tax asset associated with our tax receivable agreement. Exclusive of this adjustment, the remaining income tax provision for the three months ended September 30, 2010 consisted of \$0.5 million in operating company unincorporated business taxes and \$0.6 million in corporate income taxes. The income tax provision/(benefit) for the three months ended September 30, 2009 was a benefit of \$2.0 million and was generated primarily due to a reduction of \$3.1 million to the valuation allowance against our deferred tax asset associated with our tax receivable agreement. Exclusive of this adjustment, the remaining income tax provision for the three months ended September 30, 2009 consisted of \$0.5 million in operating company unincorporated business taxes and \$0.5 million in corporate income taxes. A comparison of the effective tax rate for the three months ended September 30, 2010 to that of the three months ended September 30, 2009 is not meaningful due to the valuation allowance adjustments.

Nine Months Ended September 30, 2010 versus September 30, 2009

The income tax provision/(benefit) was a provision of \$1.4 million for the nine months ended September 30, 2010. Exclusive of a reduction of \$2.1 million to the income tax provision related to an increase to the valuation allowance against our deferred tax asset associated with our tax receivable agreement, the remaining income tax provision for the nine months ended September 30, 2010 consisted of \$1.8 million in operating company unincorporated business taxes and \$1.7 million in corporate income taxes. The income tax provision/(benefit) for the nine months ended September 30, 2009 was a benefit of \$2.4 million and was generated primarily due to a reduction of \$4.8 million to the valuation allowance against our deferred tax asset associated with our tax receivable agreement. Exclusive of this adjustment, the remaining income tax provision for the nine months ended September 30, 2009 consisted of \$1.3 million in operating company unincorporated business taxes and \$1.1 million in corporate income taxes. A comparison of the effective tax rate for the nine months ended September 30, 2010 to that of the nine months ended September 30, 2009 is not meaningful due to the valuation allowance adjustments.

Non-Controlling Interests

Three Months Ended September 30, 2010 versus September 30, 2009

Net income attributable to non-controlling interests was \$8.0 million for the three months ended September 30, 2010, and consisted of \$7.7 million associated with our employees' and outside investors' interest in the income of the operating company and \$0.3 million of income from our consolidated subsidiaries' interest in the earnings of our consolidated investment partnerships. Net income attributable to non-controlling interests was \$10.8 million for the three months ended September 30, 2009, and consisted of \$8.1 million associated with our employees' and outside investors' interest in the income of the operating company and \$2.8 million of income from our consolidated subsidiaries' interest in the earnings of our consolidated investment partnerships. The increase in the interest in the earnings of the operating company is primarily a result of the increase in our weighted average AUM, which had a corresponding positive impact on revenues and income. The decrease in our consolidated subsidiaries' interest in the earnings of our consolidated investment partnerships is primarily a result of the deconsolidation of the Pzena Global Value Service and the Pzena EAFE Value Service on December 31, 2009, and the deconsolidation of the Pzena Emerging Market Countries Value Service and the Pzena Emerging Markets Focused Value Service during the three months ended September 30, 2010.

Nine Months Ended September 30, 2010 versus September 30, 2009

Net income attributable to non-controlling interests was \$23.6 million for the nine months ended September 30, 2010, and consisted of \$23.5 million associated with our employees' and outside investors' interest in the income of the operating company and \$0.1 million of income from our consolidated subsidiaries' interest in the earnings of our consolidated investment partnerships. Net income attributable to non-controlling interests was \$21.5 million for the nine months ended September 30, 2009, and consisted of approximately \$17.7 million associated with our employees' and outside investors' interest in the income of the operating company and \$3.8 million of income from our consolidated subsidiaries' interest in the earnings of our consolidated investment partnerships. The increase in the interest in the earnings of the operating company is primarily a result of the increase in our weighted average AUM, which had a corresponding positive impact on revenues and income. The decrease in our consolidated subsidiaries' interest in the earnings of our consolidated investment partnerships is primarily a result of the deconsolidation of the Pzena Global Value Service and the Pzena EAFE Value Service on December 31, 2009, and the deconsolidation of the Pzena Emerging Market Countries Value Service and the Pzena Emerging Markets Focused Value Service during the three months ended September 30, 2010.

Non-GAAP Net Income

Our results for the three and nine months ended September 30, 2010 and 2009 included adjustments related to our tax receivable agreement and the associated liability to our selling and converting shareholders. Excluding these adjustments, diluted net income and diluted net income per share was \$5.2 million and \$0.08, respectively, for the three months ended September 30, 2010, and \$5.3 million and \$0.08, respectively, for the three months ended September 30, 2009. On a similar basis, diluted net income and diluted net income per share was \$15.7 million and \$0.24, respectively, for the nine months ended September 30, 2010, and \$11.7 million and \$0.18, respectively, for the nine months ended September 30, 2009. We believe that excluding these adjustments provides information to better analyze our operations between periods and over time. Investors should consider these non-GAAP measures in addition to, and not as a substitute for, financial measures prepared in accordance with GAAP.

A reconciliation of the non-GAAP measures to the most comparable GAAP measures is included below:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009

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

GAAP Net Income	\$ 1,219	\$ 1,432	\$ 2,676	\$ 2,736
Net Effect of Tax Receivable Agreement	461	711	440	1,197
Non-GAAP Net Income	<u>\$ 758</u>	<u>\$ 721</u>	<u>\$ 2,236</u>	<u>\$ 1,539</u>
GAAP Non-Controlling Interest of Pzena Investment Management, LLC	\$ 7,722	\$ 8,082	\$ 23,483	\$ 17,767
Less: Assumed Corporate Income Taxes	3,309	3,463	10,063	7,613
Assumed After-Tax Income of Pzena Investment Management, LLC	<u>\$ 4,413</u>	<u>\$ 4,619</u>	<u>\$ 13,420</u>	<u>\$ 10,154</u>
Non-GAAP Net Income of Pzena Investment Management, Inc.	758	721	2,236	1,539
Non-GAAP Diluted Net Income	<u>\$ 5,171</u>	<u>\$ 5,340</u>	<u>\$ 15,656</u>	<u>\$ 11,693</u>
Non-GAAP Diluted Earnings Per Share Attributable to Pzena Investment Management, Inc. Common Stockholders:				
Non-GAAP Net Income for Diluted Earnings per Share	\$ 5,171	\$ 5,340	\$ 15,656	\$ 11,693
Non-GAAP Diluted Earnings per Share	\$ 0.08	\$ 0.08	\$ 0.24	\$ 0.18
Non-GAAP Diluted Weighted Average Shares Outstanding	64,993,746	64,994,278	65,006,198	64,756,331

Liquidity and Capital Resources

Historically, the working capital needs of our business have primarily been met through cash generated by our operations. Distributions to members of our operating company and loan amortization payments have been our largest use of cash from financing activities. Investing activities have historically been investments in our own investment strategies and, to a lesser extent, capital expenditures.

At September 30, 2010, our cash and cash equivalents was \$26.8 million. Advisory fees receivable were \$14.2 million.

We expect to fund the liquidity needs of our business in the next twelve months, and over the long term, primarily through cash generated from operations. As an investment management firm, our business has been materially affected by conditions in the global financial markets and economic conditions throughout the world. Our liquidity is highly dependent on the revenue and income from our operations, which is directly related to our levels of AUM. As of and for the three months ended September 30, 2010, our weighted average AUM and revenues increased by 11.5% and 10.1%, respectively, compared to the three months ended September 30, 2009. These increases contributed to a 28.6% increase in our cash provided by operating activities for the comparable period. As of and for the nine months ended September 30, 2010, our weighted average AUM and revenues increased by 32.7% and 27.5%, respectively, compared to the nine months ended September 30, 2009. These increases contributed to a 35.2% increase in our cash provided by operating activities for the comparable period.

In determining the sufficiency of liquidity and capital resources to fund our business, we regularly monitor our liquidity position, including, among other things, cash, working capital, investments, long-term liabilities, lease commitments, debt obligations, and operating company distributions. Further, we consider cash compensation, one of our largest expenses, as sufficiently variable such that it can be adjusted to mitigate any potential decline in revenue we may experience in the next twelve months. We continuously evaluate our staffing requirements and compensation levels with reference to our own liquidity position and external peer benchmarking data. The result of this review directly influences management's recommendations to our Board of Directors with respect to such staffing and compensation levels.

We anticipate that distributions to the members of our operating company, which consisted of 34 of our employees, certain unaffiliated persons, two former employees, and us, will continue to be a material financing activity.

During the nine months ended September 30, 2010, we repaid the remaining \$10.0 million principal amount outstanding of the Senior Subordinated Notes held by the entities established by Richard S. Pzena. Although we are comfortable with our current capital structure, in the current economic environment, it is uncertain whether additional or alternative sources of debt or equity financing, if required, would be available on acceptable terms.

We do not anticipate meaningful outlays for internal investment or capital expenditures over the next twelve months.

We believe that the repayment of our term loan and Senior Subordinated Notes, and our ability to vary cash compensation levels, have provided us with an appropriate degree of flexibility in providing for our liquidity needs.

Dividend Policy

We are a holding company and have no material assets other than our ownership of membership interests in our operating company. As a result, we depend upon distributions from our operating company to pay any dividends that our Board of Directors may declare to be paid to our Class A common stockholders. When, and if, our Board of Directors declares any such dividends, we then cause our operating company to make distributions to us in an amount sufficient to cover the amount of the dividends declared. Our dividend policy has certain risks and limitations, particularly with respect to liquidity. We may not pay dividends to our Class A common shareholders in amounts that have been paid to them in the past, or at all, if, among other things, we do not have the cash necessary to pay our intended dividends. To the extent we do not have cash on hand sufficient to pay dividends in the future, we may decide not to pay dividends. By paying cash dividends rather than investing that cash in our future growth, we risk slowing the pace of our growth, or not having a sufficient amount of cash to fund our operations or unanticipated capital expenditures, should the need arise.

Term Loan and Senior Subordinated Notes

During the year ended December 31, 2009, we used cash generated from operations to repay the remaining \$22.0 million of the principal amount outstanding under our term loan. Concurrently with the termination of this term loan, a security interest in our accounts receivable and one of our subsidiaries was released by the lender in September 2009.

During the nine months ended September 30, 2010, we used cash on hand to repay the remaining \$10.0 million principal amount outstanding of the Senior Subordinated Notes held by the entities established by Richard S. Pzena.

Tax Receivable Agreement

Our purchase of Class B units of our operating company concurrently with our initial public offering, and the subsequent and future exchanges by holders of Class B units of our operating company for shares of our Class A common stock (pursuant to the exchange rights provided for in the operating company's operating agreement), has resulted in, and is expected to continue to result in, increases in our share of the tax basis of the tangible and intangible assets of our operating company at the time of our acquisitions and these subsequent and future exchanges, which will increase the tax depreciation and amortization deductions that otherwise would not have been available to us. These increases in tax basis and tax depreciation and amortization deductions have reduced, and are expected to continue to reduce, the amount of tax that we would otherwise be required to pay in the future. We have entered into a tax receivable agreement with the current members of our operating company, the one member of our operating company immediately prior to our initial public offering who sold all of its Class B units to us in connection with our initial public offering, and any future holders of Class B units, that requires us to pay them 85% of the amount of cash savings, if any, in U.S. federal, state and local income tax that we actually realize (or are deemed to realize in the case of an early termination payment by us, or a change in control, as described in the tax receivable agreement) as a result of the increases in tax basis described above and certain other tax benefits related to entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement.

In October 2008, the selling unitholders agreed to waive any payments that we were required to make to them for the 2008 and 2009 tax years pursuant to the tax receivable agreement.

Cash Flows

Operating activities provided cash of \$9.9 million and \$7.7 million for the three months ended September 30, 2010 and 2009, respectively. Operating activities provided \$37.5 million and \$25.6 million for the nine months ended September 30, 2010 and 2009, respectively. The year-over-year increase in cash flows from operating activities was driven primarily by an increase in weighted average AUM from \$12.2 billion for the three months ended September 30, 2009, to \$13.6 billion for the three months ended September 30, 2010, and an increase in weighted average AUM from \$10.7 billion for the nine months ended September 30, 2009, to \$14.2 billion for the nine months ended September 30, 2010, which had a corresponding positive impact on total revenues.

Investing activities consist primarily of investments in affiliates and other investment partnerships, as well as capital expenditures. Investing activities used less than \$0.1 million for each of the three months ended September 30, 2010 and 2009. Investing activities provided less than \$0.1 million for the nine months ended September 30, 2010, and had no net effect for the nine months ended September 30, 2009.

Financing activities consist primarily of borrowing arrangements and distributions to and contributions from non-controlling interests. Financing activities used \$6.6 million and \$14.4 million of cash for the three months ended September 30, 2010 and 2009, respectively. The \$7.8 million decrease in financing activities is primarily attributable to a \$10.0 million decrease in principal repayments associated with our debt obligations, offset by a \$1.6 million increase in distributions to non-controlling interests, a \$0.3 million decrease in contributions from non-controlling interests, and a \$0.3 million increase in dividends paid.

Financing activities used \$26.5 million and \$33.9 million for the nine months ended September 30, 2010 and 2009, respectively. The \$7.4 million decrease in financing activities is primarily attributable to a \$12.0 million decrease in principal repayments associated with our debt obligations and a \$4.0 million increase in contributions from non-controlling interests, offset by a \$8.0 million increase in distributions to non-controlling interests and a \$0.6 million increase in dividends paid.

Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements as of September 30, 2010.

Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements in accordance with U.S. generally accepted accounting principles (“GAAP”) requires management to make estimates and judgments that affect our reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under current circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily available from other sources. We evaluate our estimates on an ongoing basis. Actual results may differ from these estimates under different assumptions or conditions.

Accounting policies are an integral part of our financial statements. A thorough understanding of these accounting policies is essential when reviewing our reported results of operations and our financial condition. Management believes that the critical accounting policies discussed below involve additional management judgment due to the sensitivity of the methods and assumptions used.

Consolidation

Our policy is to consolidate all majority-owned subsidiaries in which we have a controlling financial interest and VIEs of which we are deemed to be the primary beneficiary. We also consolidate non-VIEs which we control as the general partner or managing member. We assess our consolidation practices regularly, as circumstances dictate. All significant inter-company transactions and balances have been eliminated.

Income Taxes

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

We recognize deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, net operating loss carryforwards and tax credits. A valuation allowance is maintained for deferred tax assets that we estimate are more likely than not to be unrealizable based on available evidence at the time the estimate is made. Determining the valuation allowance requires significant management judgments and assumptions. In determining the valuation allowance, we use historical and forecasted future operating results, based upon approved business plans, including a review of the eligible carryforward periods, tax planning opportunities and other relevant considerations. Each quarter, we re-evaluate our estimate related to the valuation allowance, including our assumptions about future profitability.

We believe that the accounting estimate related to the \$61.4 million valuation allowance, assessed as of September 30, 2010 against the deferred tax asset associated with our acquisitions of operating company Class B units, is a critical accounting estimate because the underlying assumptions can change from period to period. For example, tax law changes, or variances in future projected operating performance, could result in a change in the valuation allowance. If we were not able to realize all or part of our net deferred tax assets in the future, an adjustment to our deferred tax assets valuation allowance would be charged to income tax expense in the period such determination was made.

Management judgment is required in determining our provision for income taxes, evaluating our tax positions and establishing deferred tax assets and liabilities. The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. If our estimate of tax liabilities proves to be less than the ultimate assessment, a further charge to earnings would result.

Recent Accounting Pronouncements

In September 2009, the FASB issued a new standard that requires an enterprise to perform a qualitative analysis to determine whether its variable-interests give it a controlling financial interest in a VIE. Under the standard, an enterprise has a controlling financial interest when it has (a) the power to direct the activities of a VIE that most significantly impact the entity's economic performance, and (b) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. An enterprise that holds a substantive interest and a controlling financial interest in a VIE is deemed to be the primary beneficiary of the VIE and is required to consolidate the VIE. The standard also requires an ongoing assessment of whether an enterprise is the primary beneficiary of a VIE, and additional disclosures about an enterprise's involvement in VIEs, and any significant changes in risk exposure due to that involvement. The standard is effective for fiscal years beginning after November 15, 2009. In November 2009, the FASB issued a proposed standard update, which defers the consolidation criteria requirements of this new standard for assets managers' interests in entities that apply the specialized accounting guidance for investment companies, or that have the attributes of investment companies. In February 2010, the FASB issued further guidance which provided a limited scope deferral for a reporting entity's interest in an entity that meets all of the following conditions: (a) the entity has all the attributes of an investment company as defined under AICPA Audit and Accounting Guide, Investment Companies, or does not have all the attributes of an investment company but is an entity for which it is acceptable based on industry practice to apply measurement principles that are consistent with the AICPA Audit and Accounting Guide, Investment Companies, (b) the reporting entity does not have explicit or implicit obligations to fund any losses of the entity that could potentially be significant to the entity, and (c) the entity is not a securitization entity, asset-backed financing entity or an entity that was formerly considered a qualifying special-purpose entity. The reporting entity is required to perform a consolidation analysis for entities that qualify for the deferral in accordance with previously issued guidance on VIEs. We have evaluated the deferral guidelines and determined that the standard is applicable for our investment in our operating company, but that we meet the criteria for deferral provided in this standard for our VIEs. We adopted the updated guidance on January 1, 2010, and it had no impact on our consolidated financial statements. We are monitoring future guidance for updates on the treatment of our interests in our VIEs.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Market Risk

Our exposure to market risk is directly related to our role as investment adviser for the institutional separate accounts we manage and the retail clients for which we act as a sub-investment adviser. Global markets have experienced unprecedented volatility, and the current economic environment is challenging. Market conditions have, in the recent past, resulted in a significant reduction in our AUM, which in turn directly impacted our revenues and net income. A resumption of the economic downturn, and volatility in the global financial markets, could also significantly affect the estimates, judgments, and assumptions used in the valuation of our financial instruments.

All of our revenue for the three and nine months ended September 30, 2010 and 2009 was derived from advisory fees, which are typically based on the market value of AUM, which can be affected by adverse changes in interest rates, foreign currency exchange and equity prices. Accordingly, a decline in the prices of securities would cause our revenue and earnings to decline due to a decrease in the value of the assets we manage. In addition, such a decline could cause our clients to withdraw their funds in favor of investments offering higher returns or lower risk, which would cause our revenue and earnings to decline further.

We are also subject to market risk due to a decline in the value of holdings in mutual funds. At September 30, 2010, the fair value of these assets was \$2.3 million. Assuming a 10% increase or decrease, the fair value would have increased or decreased by \$0.2 million at September 30, 2010.

Interest Rate Risk

We have no exposure to interest rate risk at September 30, 2010.

Item 4. Controls and Procedures.

During the course of their review of our consolidated financial statements as of September 30, 2010, our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2010, our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) were effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There have not been any changes in our internal control over financial reporting during the three and nine months ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

In the normal course of business, we may be subject to various legal and administrative proceedings.

Currently, there are no material legal proceedings pending against us.

Item 1A. Risk Factors.

There are no material changes from the risk factors set forth in Part 1, Item 1A of the Company's 2009 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. (Removed and Reserved).

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit	Description of Exhibit
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a)/15(d)-14(a)
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a)/15(d)-14(a)
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: November 4, 2010

PZENA INVESTMENT MANAGEMENT, INC.

By: /s/ RICHARD S. PZENA
Name: Richard S. Pzena
Title: *Chief Executive Officer*

By: /s/ GREGORY S. MARTIN
Name: Gregory S. Martin
Title: *Chief Financial Officer and Principal Accounting Officer*