

Edgar Filing: Pzena Investment Management, Inc. - Form 10-Q

Pzena Investment Management, Inc.

Form 10-Q

November 01, 2013

Table of Contents

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, 2013

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)

120 West 45th Street

New York, New York 10036

(Address of Principal Executive Offices) (Zip Code)

20-8999751

(I.R.S. Employer

Identification No.)

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 ☐

Smaller reporting company ☒

(Do not check if a smaller reporting company)

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

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As of October 31, 2013, there were 12,148,057 outstanding shares of the registrant's Class A common stock, par value \$0.01 per share.

As of October 31, 2013, there were 52,347,732 outstanding shares of the registrant's Class B common stock, par value \$0.000001 per share.

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Table of Contents

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

	Page
<u>PART I — FINANCIAL INFORMATION</u>	
<u>Item 1.</u>	<u>Financial Statements</u>
	<u>Consolidated Statements of Financial Condition of Pzena Investment Management, Inc. as of September 30, 2013 (unaudited) and December 31, 2012</u>
	<u>1</u>
	<u>Consolidated Statements of Operations (unaudited) of Pzena Investment Management, Inc. for the Three and Nine Months Ended September 30, 2013 and 2012</u>
	<u>2</u>
	<u>Consolidated Statement of Changes in Equity (unaudited) of Pzena Investment Management, Inc. for the Nine Months Ended September 30, 2013</u>
	<u>3</u>
	<u>Consolidated Statements of Cash Flows (unaudited) of Pzena Investment Management, Inc. for the Three and Nine Months Ended September 30, 2013 and 2012</u>
	<u>4</u>
	<u>Notes to the Consolidated Financial Statements (unaudited)</u>
	<u>5</u>
<u>Item 2.</u>	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>
	<u>21</u>
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>
	<u>38</u>
<u>Item 4.</u>	<u>Controls and Procedures</u>
	<u>39</u>
<u>PART II — OTHER INFORMATION</u>	
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>
	<u>40</u>
<u>Item 6.</u>	<u>Exhibits</u>
	<u>40</u>

SIGNATURES

Table of Contents

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

Forward-looking statements are subject to known and unknown risks and uncertainties and are based on potentially inaccurate assumptions that could cause actual results to differ materially from those expected or implied by the forward-looking statements. Our actual results could differ materially from those anticipated in forward-looking statements for many reasons, including the factors described in Item 1A, “Risk Factors” in Part I of our Annual Report on Form 10-K for our fiscal year ended December 31, 2012. 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](http://www.sec.gov), identify additional factors that can affect forward-looking statements.

Table of Contents

## 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, 2013 (unaudited)	December 31, 2012
<b>ASSETS</b>		
Cash and Cash Equivalents	\$34,962	\$32,645
Restricted Cash	1,031	1,030
Due from Broker	232	22
Advisory Fees Receivable	19,900	14,626
Investments, at Fair Value	7,237	5,170
Receivable from Related Parties	126	83
Other Receivables	565	51
Prepaid Expenses and Other Assets	758	585
Deferred Tax Asset, Net of Valuation Allowance of \$54,353 and \$59,917 in 2013 and 2012, respectively	13,254	9,688
Property and Equipment, Net of Accumulated Depreciation of \$2,798 and \$2,695 in 2013 and 2012, respectively	829	779
<b>TOTAL ASSETS</b>	<b>\$78,894</b>	<b>\$64,679</b>
<b>LIABILITIES AND EQUITY</b>		
<b>Liabilities:</b>		
Accounts Payable and Accrued Expenses	\$14,577	\$4,305
Due to Broker	64	23
Liability to Selling and Converting Shareholders	12,859	9,656
Lease Liability	884	1,203
Deferred Compensation Liability	1,649	1,327
Other Liabilities	135	199
<b>TOTAL LIABILITIES</b>	<b>30,168</b>	<b>16,713</b>
<b>Equity:</b>		
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; 12,177,202 and 11,149,941 Shares Issued and Outstanding in 2013 and 2012, respectively)		111
Class B Common Stock (Par Value \$0.000001; 750,000,000 Shares Authorized; 52,190,656 and 53,482,324 Shares Issued and Outstanding in 2013 and 2012, respectively)		—
Additional Paid-In Capital	10,548	11,765
Retained Earnings	4,578	2,693
Total Pzena Investment Management, Inc.'s Equity	15,246	14,569
Non-Controlling Interests	33,480	33,397
<b>TOTAL EQUITY</b>	<b>48,726</b>	<b>47,966</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$78,894</b>	<b>\$64,679</b>

See accompanying notes to unaudited consolidated financial statements.



Table of Contents

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,	
	2013	2012	2013	2012
REVENUE	\$24,046	\$18,861	\$67,020	\$56,968
EXPENSES				
Compensation and Benefits Expense	9,100	7,689	27,622	23,874
General and Administrative Expense	1,995	1,764	5,747	5,383
Total Operating Expenses	11,095	9,453	33,369	29,257
Operating Income	12,951	9,408	33,651	27,711
OTHER INCOME/(EXPENSE)				
Interest Income	30	51	84	146
Interest Expense	—	—	—	(26)
Dividend Income	52	43	168	101
Net Realized and Unrealized Gain/ (Loss) from Investments	498	395	1,763	1,061
Change in Liability to Selling and Converting Shareholders	(3,257)	(1,684)	(4,525)	(2,342)
Other (Expense)	(71)	(44)	(159)	(11)
Total Other Income/ (Expense)	(2,748)	(1,239)	(2,669)	(1,071)
Income Before Income Taxes	10,203	8,169	30,982	26,640
Income Tax (Benefit)/ Expense	(2,084)	(827)	(1,288)	953
Net Income	12,287	8,996	32,270	25,687
Less: Net Income Attributable to Non-Controlling Interests	10,331	7,733	27,879	22,803
Net Income Attributable to Pzena Investment Management, Inc.	\$1,956	\$1,263	\$4,391	\$2,884
Net Income for Basic Earnings per Share	\$1,956	\$1,263	\$4,391	\$2,884
Basic Earnings per Share	\$0.16	\$0.12	\$0.37	\$0.27
Basic Weighted Average Shares Outstanding	12,209,978	10,780,603	11,934,142	10,640,878
Net Income for Diluted Earnings per Share	\$7,866	\$5,562	\$20,129	\$15,594
Diluted Earnings per Share	\$0.12	\$0.09	\$0.30	\$0.24
Diluted Weighted Average Shares Outstanding <sup>1</sup>	66,714,033	65,404,610	66,610,381	65,382,457
Cash Dividends per Share of Class A Common Stock	\$0.03	\$0.03	\$0.22	\$0.25

<sup>1</sup> Under the "two-class method," restricted Class B units that are considered participating securities are required to be included in the computation of diluted earnings per share.

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

## PZENA INVESTMENT MANAGEMENT, INC.

## UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

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

	Shares of Class A Common Stock	Shares of Class B Common Stock	Class A Common Stock	Additional Paid-In Capital	Retained Earnings	Non-Controlling Interests	Total
Balance at December 31, 2012	11,149,941	53,482,324	\$ 111	\$ 11,765	\$ 2,693	\$ 33,397	\$ 47,966
Unit Conversion	1,328,334	(1,328,334 )	13	746	—	(640 )	119
Amortization of Non-Cash Compensation	7,414	36,666	—	403	—	1,781	2,184
Directors' Shares	45,818	—	—	47	—	207	254
Net Income	—	—	—	—	4,391	27,879	32,270
Repurchase and Retirement of Class A Common Stock	(354,305 )	—	(4 )	(2,209 )	—	—	(2,213 )
Repurchase and Retirement of Class B Unit Options	—	—	—	(14 )	—	(57 )	(71 )
Class A Cash Dividends Declared and Paid (\$0.22 per share)	—	—	—	—	(2,506 )	—	(2,506 )
Contributions from Non-Controlling Interests	—	—	—	—	—	128	128
Distributions to Non-Controlling Interests	—	—	—	—	—	(29,405 )	(29,405 )
Other	—	—	—	(190 )	—	190	—
Balance at September 30, 2013	12,177,202	52,190,656	\$ 120	\$ 10,548	\$ 4,578	\$ 33,480	\$ 48,726

See accompanying notes to unaudited consolidated financial statements.



Table of Contents

## PZENA INVESTMENT MANAGEMENT, INC.

## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
<b>OPERATING ACTIVITIES</b>				
Net Income	\$ 12,287	\$ 8,996	\$ 32,270	\$ 25,687
Adjustments to Reconcile Net Income to Cash Provided by Operating Activities:				
Depreciation	47	56	124	171
Disposal of Fixed Assets	—	—	—	(93)
Non-Cash Compensation	1,313	722	3,832	2,073
Director Share Grant	104	70	254	210
Net Realized and Unrealized (Gain) from Investments	(498)	) (395)	) (1,763)	) (1,061)
Change in Liability to Selling and Converting Shareholders	3,257	1,684	4,525	2,342
Deferred Income Taxes	(2,881)	) (1,440)	) (2,788)	) (829)
Changes in Operating Assets and Liabilities:				
Advisory Fees Receivable	(1,526)	) (184)	) (5,274)	) 103
Due from Broker	(147)	) (1,769)	) (210)	) (3,287)
Restricted Cash	—	—	(1)	) —
Prepaid Expenses and Other Assets	(121)	) 144	(687)	) 200
Due to Broker	(4)	) 326	41	1,741
Accounts Payable, Accrued Expenses, and Other Liabilities	4,506	3,831	8,898	8,088
Tax Receivable Agreement Payments	—	—	(2,000)	) (2,093)
Change in Lease Liability	(107)	) (153)	) (319)	) (460)
Purchases of Investments	(10,235)	) (24,861)	) (63,441)	) (56,284)
Proceeds from Sale of Investments	11,843	24,780	64,545	56,735
Net Cash Provided by Operating Activities	17,838	11,807	38,006	33,243
<b>INVESTING ACTIVITIES</b>				
Purchases of Investments in Deferred Compensation Plan	(24)	) (30)	) (1,483)	) (492)
Proceeds from Investments in Deferred Compensation Plan	—	—	78	544
Payments from/ (to) Related Parties	5	(61)	) (43)	) (95)
Purchase of Property and Equipment	(169)	) (3)	) (174)	) (4)
Net Cash (Used in)/Provided by Investing Activities	(188)	) (94)	) (1,622)	) (47)
<b>FINANCING ACTIVITIES</b>				
Repurchase and Retirement of Class A Common Stock	(529)	) (127)	) (2,213)	) (252)
Repurchase and Retirement of Class B Unit Options	—	(15)	) (71)	) (15)
Distributions to Non-Controlling Interests	(7,596)	) (5,014)	) (29,405)	) (27,284)
Contributions from Non-Controlling Interests	128	—	128	45
Dividends	(366)	) (317)	) (2,506)	) (2,643)
Net Cash Used in Financing Activities	(8,363)	) (5,473)	) (34,067)	) (30,149)
NET CHANGE IN CASH	\$ 9,287	\$ 6,240	\$ 2,317	\$ 3,047

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CASH AND CASH EQUIVALENTS - Beginning of Period	\$25,675	\$31,890	\$32,645	\$35,083
Net Change in Cash	9,287	6,240	2,317	3,047
CASH AND CASH EQUIVALENTS - End of Period	\$34,962	\$38,130	\$34,962	\$38,130
Supplementary Cash Flow Information:				
In-Kind Distribution to Non-Controlling Interests of Equity Securities, at Fair Value	\$—	\$—	\$—	\$371
Interest Paid	\$—	\$—	\$—	\$26
Income Taxes Paid	\$668	\$577	\$2,501	\$2,310

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

Pzena Investment Management, Inc.

Notes to Unaudited Consolidated Financial Statements

## Note 1—Organization

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

The operating company is an investment adviser which is registered under the Investment Advisers Act of 1940 and is headquartered in New York, New York. As of September 30, 2013, the operating company managed assets in a variety of value-oriented investment strategies across a wide range of market capitalizations in both U.S. and non-U.S. capital markets.

The Company, through its investment in its operating company, has consolidated the results of operations and financial condition of the following entities as of September 30, 2013:

Legal Entity	Type of Entity (Date of Formation)	Operating Company's Ownership at September 30, 2013	
Pzena Investment Management, Pty	Australian Proprietary Limited Company (12/16/2009)	100.0	%
Pzena Investment Management Special Situations, LLC	Delaware Limited Liability Company (12/01/2010)	99.9	%
Pzena Investment Funds Trust, Pzena Large Cap Value Fund	Massachusetts Trust (11/01/2002)	0.0	%
Pzena International Value Service, a series of Pzena Investment Management International, LLC	Delaware Limited Liability Company (12/22/2003)	0.0	%

## Note 2—Significant Accounting Policies

## Basis of Presentation:

The consolidated financial statements are prepared in conformity with U.S. generally accepted accounting principles (“GAAP”) and related Securities and Exchange Commission (“SEC”) rules and regulations. The Company’s policy is to consolidate all majority-owned subsidiaries in which it has a controlling financial interest, which includes Pzena Investment Management, Pty and Pzena Investment Management Special Situations, LLC. The Company also consolidates variable-interest entities (“VIEs”) where the Company is deemed to be the primary beneficiary, which includes Pzena Investment Funds Trust, Pzena Large Cap Value Fund (“Pzena Large Cap Value Fund”) and Pzena International Value Service, a series of Pzena Investment Management International, LLC (“Pzena International Value Fund”). These majority-owned subsidiaries in which the Company has a controlling financial interest and the VIEs where the Company is deemed to be the primary beneficiary are collectively referred to as “consolidated subsidiaries.” As required by the Consolidation Topic of the Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”), the Company also consolidates non-variable-interest entities in which it acts or

acted as the general partner or managing member. All of these entities represent or represented private investment partnerships over which the Company exercises or exercised control. Non-controlling interests recorded on the consolidated financial statements of the Company include the non-controlling interests of the outside investors in each of these entities, as well as those of the operating company. All significant inter-company transactions and balances have been eliminated.

The operating company is the managing member of Pzena International Value Fund. As of February 1, 2011, as a result of a shift in the equity ownership of that fund on that date, the operating company was considered the primary beneficiary of this fund and, as a result, the fund was consolidated with the Company as of that date. At September 30, 2013, Pzena International Value Fund's \$1.2 million in net assets were included in the Company's consolidated statements of financial condition.

Table of Contents

Pzena Investment Management, Inc.

Notes to Unaudited Consolidated Financial Statements (Continued)

Pzena Large Cap Value Fund is a Massachusetts Trust in which a majority of the trustees are members of the executive committee of the operating company. A majority of the trustees do not hold equity investments in this trust. Since the holders of the equity investments in this partnership lack a controlling financial interest in it, this entity is deemed to be a VIE. The Company is considered the primary beneficiary of this VIE. At September 30, 2013, the Pzena Large Cap Value Fund's \$1.2 million in net assets were included in the Company's consolidated statements of financial condition.

All of the consolidated investment partnerships are investment companies under the American Institute of Certified Public Accountants Audit and Accounting Guide for Investment Companies. The Company has retained the specialized accounting for these partnerships pursuant to the Consolidation of Partnerships and Similar Entities Subtopic of the