

Pzena Investment Management, Inc.
Form 10-K
March 14, 2012

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K**

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended December 31, 2011

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)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Class A Common Stock, par value \$.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 <input type="radio"/>	Accelerated filer <input checked="" type="radio"/>	Non-accelerated filer <input type="radio"/>	Smaller reporting company <input type="radio"/>
---	--	---	---

(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

The aggregate market value of the common equity held by non-affiliates of the registrant as of June 30, 2011, the last business day of its most recently completed second fiscal quarter, was approximately \$51,797,346 based on the closing sale price of \$5.68 per share of Class A common stock of the registrant on such date on the New York Stock Exchange. For purposes of this calculation only, it is assumed that the affiliates of the registrant include only directors and executive officers of the registrant.

As of March 2, 2012, there were 10,575,089 outstanding shares of the registrant's Class A common stock, par value \$0.01 per share.

Securities registered pursuant to Section 12(b) of the Act:

As of March 2, 2012, there were 54,222,542 outstanding shares of the registrant's Class B common stock, par value \$0.000001 per share.

DOCUMENTS INCORPORATED BY REFERENCE

None.

TABLE OF CONTENTS

TABLE OF CONTENTS

	Page
<u>Cautionary Statement Regarding Forward-Looking Statements</u>	<u>ii</u>
PART I	
<u>Item 1.</u>	<u>1</u>
<u>Business</u>	
<u>Item 1A.</u>	<u>13</u>
<u>Risk Factors</u>	
<u>Item 1B.</u>	<u>28</u>
<u>Unresolved Staff Comments</u>	
<u>Item 2.</u>	<u>28</u>
<u>Properties</u>	
<u>Item 3.</u>	<u>28</u>
<u>Legal Proceedings</u>	
<u>Item 4.</u>	<u>28</u>
<u>Removed and Reserved</u>	
PART II	
<u>Item 5.</u>	<u>29</u>
<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer</u>	
<u>Purchases of Equity Securities</u>	
<u>Item 6.</u>	<u>32</u>
<u>Selected Financial Data</u>	
<u>Item 7.</u>	<u>34</u>
<u>Management's Discussion and Analysis of Financial Condition and Results</u>	
<u>of Operations</u>	
<u>Item 7A.</u>	<u>53</u>
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	
<u>Item 8.</u>	<u>53</u>
<u>Financial Statements and Supplementary Data</u>	
<u>Item 9.</u>	<u>53</u>
<u>Changes in and Disagreements with Accountants on Accounting and</u>	

<u>Financial Disclosure</u>	
<u>Item 9A.</u>	<u>53</u>
<u>Controls and Procedures</u>	
<u>Item 9B.</u>	<u>54</u>
<u>Other Information</u>	
PART III	
<u>Item 10.</u>	<u>55</u>
<u>Directors, Executive Officers and Corporate Governance</u>	
<u>Item 11.</u>	<u>61</u>
<u>Executive Compensation</u>	
<u>Item 12.</u>	<u>73</u>
<u>Security Ownership of Certain Beneficial Owners and Management and Related</u>	
<u>Stockholder Matters</u>	
<u>Item 13.</u>	<u>82</u>
<u>Certain Relationships and Related Transactions, and Director Independence</u>	
<u>Item 14.</u>	<u>89</u>
<u>Principal Accountant Fees and Services</u>	
PART IV	
<u>Item 15.</u>	<u>90</u>
<u>Exhibits and Financial Statement Schedules</u>	
<u>SIGNATURES</u>	<u>93</u>

TABLE OF CONTENTS

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K, or Annual Report, 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, 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 this Annual Report. Accordingly, you should not unduly rely on these forward-looking statements, which speak only as of the date of this Annual Report. We undertake no obligation to publicly revise any forward-looking statements to reflect circumstances or events after the date of this Annual 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 Annual Report.

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.

TABLE OF CONTENTS

Preliminary Notes

In this Annual Report, we, our, and us refers to Pzena Investment Management, Inc. (also referred to as the Company) and its consolidated subsidiaries, except that, prior to the consummation of our initial public offering and the reorganization on October 30, 2007, these terms refer to Pzena Investment Management, LLC and its consolidated subsidiaries.

Each Russell Index referred to in this Annual Report is a registered trademark or trade name of The Frank Russell Company®. The Frank Russell Company® is the owner of all copyrights relating to these indices and is the source of the performance statistics of these indices that are referred to herein.

The Morgan Stanley Capital International EAFE® Index, which we refer to as the MSCI EAFE® Index, is a trademark of Morgan Stanley Capital International, a division of Morgan Stanley. The Morgan Stanley Capital International WorldSM Index, which we refer to as the MSCI WorldSM Index, is a service mark of Morgan Stanley Capital International, a division of Morgan Stanley. Morgan Stanley Capital International is the owner of all copyrights relating to these indices and is the source of the performance statistics of these indices that are referred to in this Annual Report.

The S&P 500® Index is a registered trademark of Standard & Poor's, a division of The McGraw Hill Companies, Inc., which is the owner of all copyrights relating to this index and the source of the performance statistics of this index that are referred to herein.

PART I.

ITEM 1.

BUSINESS

Overview

Pzena Investment Management, Inc. is the sole managing member of Pzena Investment Management, LLC, which is our operating company. Founded in late 1995, Pzena Investment Management, LLC is a value-oriented investment management firm. We believe that we have established a positive, team-oriented culture that enables us to attract and retain very qualified people. Over the past sixteen years, we have built a diverse, global client base of respected and sophisticated institutional investors, high net worth individuals and select third-party distributed mutual funds for which we act as sub-investment adviser.

TABLE OF CONTENTS

The graphic below illustrates our holding company structure and ownership as of December 31, 2011.

(1) As of December 31, 2011, the members of Pzena Investment Management, LLC, other than us, consisted of: Our six named executive officers and their estate planning vehicles, who collectively held approximately 61.0% of the economic interests in Pzena Investment Management, LLC.

26 of our other employees, who collectively held approximately 4.2% of the economic interests in Pzena Investment Management, LLC.

Certain other members of our operating company, including one of our directors and his related entities, and five former employees, who collectively held approximately 18.5% of the economic interests in us (with the 32 employee members, the Principals).

(2) Each share of Class A common stock is entitled to one vote per share. Class A common stockholders have 100% of the rights of all classes of our capital stock to receive distributions.

(3) Each share of Class B common stock is entitled to five votes per share for so long as the number of shares of Class B common stock outstanding represents at least 20% of all shares of common stock outstanding. Class B common stockholders have the right to receive the par value of the Class B common stock upon our liquidation, dissolution or winding up, but do not share in dividends.

(4) As of December 31, 2011, we held 10,575,089 Class A units of Pzena Investment Management, LLC, which represented the right to receive 16.3% of the distributions made by Pzena Investment Management, LLC.

(5) As of December 31, 2011, the Principals collectively held 54,169,426 Class B units of Pzena Investment Management, LLC, which represented the right to receive 83.7% of the distributions made by Pzena Investment Management, LLC.

We utilize a classic value approach to investing and seek to make investments in good businesses at low prices. Our approach and process have helped us achieve attractive returns over the long term. As of December 31, 2011, we managed assets in twelve value-oriented investment strategies across a wide range of market capitalizations in both U.S. and non-U.S. capital markets. Our assets under management, or AUM, were \$13.5 billion at December 31, 2011, and we managed money on behalf of institutions and high net worth individuals and acted as sub-investment adviser to a variety of SEC-registered mutual funds and offshore funds.

TABLE OF CONTENTS

Our investment discipline and our commitment to a classic value approach have been important elements of our success. We construct concentrated portfolios selected through a rigorous fundamental research process similar to the approach of a private equity investor. Our investment decisions are not motivated by short-term results or aimed at closely tracking specific market benchmarks. Generating excess returns by utilizing a classic value investment approach requires:

willingness to invest in companies before their stock prices reflect signs of business improvement, and significant patience, based upon our understanding of the business fundamentals, and our long-term investment horizon.

As of December 31, 2011, we had 67 employees, including 32 employee members who collectively owned 65.2% of the ownership interests in our operating company. Our operating company is led by an executive committee, consisting of our Chief Executive Officer (CEO), two Presidents, and two Executive Vice Presidents.

Our Competitive Strengths

We believe that the following are our competitive strengths:

Focus on Investment Excellence. We recognize that we must achieve investment excellence in order to attain long-term business success. All of our business decisions, including the design of our investment process and our willingness to limit AUM in our investment strategies, are focused on producing attractive long-term investment results. We believe that our long-term investment performance, together with our willingness to close our strategies to new investors in order to optimize the prospects for future performance, has contributed to our positive reputation among our clients and the institutional consultants who advise them.

Consistency of Investment Process. Since our inception over sixteen years ago, we have utilized a classic value investment approach and a systematic, disciplined investment process to construct portfolios for our investment strategies in U.S. and non-U.S. markets across all market capitalizations. The consistency of our process has allowed us to leverage the same investment team to launch new products. We believe that our consistent investment process has resulted in strong brand recognition of our firm in the investment community.

Diverse and High Quality Client Base. We believe that we have developed a favorable reputation in the institutional investment community. This is evidenced by our strong relationships with consultants and the diversity and sophistication of our investors.

With the exception of two client relationships, which represented 13.3% and 11.9% of our AUM as of December 31, 2011, no other single account represented more than 5% of our AUM as of December 31, 2011. For the year ended December 31, 2011, these relationships represented 7.7% and 7.4% of our total revenues. No other single account represented more than 5% of our revenues for the year ended December 31, 2011.

Experienced Investment Professionals and a Team-Oriented Approach. Our greatest asset is the experience of the individuals on our team. In addition to detailed financial analysis, our investment process requires a long-term view of the nature of each business we are considering, the company's current and likely future competitive standing and the management team's strategies for change. Therefore, we have assembled a diverse team that includes individuals with corporate management, private equity, management consulting, legal, accounting and Wall Street experience. We believe that their wide range of experiences gives us unique perspectives while executing our in-depth, research-based decision making process. To capitalize on the diversity of these backgrounds, we follow a collaborative, consensus-oriented approach to making investment decisions, in which any of our investment professionals, irrespective of seniority, can play a significant role.

TABLE OF CONTENTS

Employee Retention. We have focused on building an environment that we believe is attractive to talented investment professionals. Important among our practices are our team-oriented approach to investment decisions, rotation of coverage areas among individuals and a culture of employee ownership of our firm.

Culture of Ownership. We believe in significant ownership of our business by the key contributors to our success. Since our inception, we have communicated to all our employees that they have the opportunity to become partners in our operating company. As of December 31, 2011, we had 32 employee-owners positioned within all functional areas of the firm. We believe this ownership model results in a shared sense of purpose with our clients and their advisers. We intend to continue fostering a culture of ownership through our equity incentive plans, which are designed to align our team's interests with those of our stockholders and clients. We believe this culture of ownership contributes to our team orientation and connection with clients.

Our Business Strategy

The key to our success is continued long-term investment performance. In conjunction with this, we believe the following strategies will enable us to grow our business over time.

Unwavering Focus on Investment Excellence. We view our unwavering focus on long-term investment excellence to be the key driver of our business success.

Capitalize on Growth Opportunities Created By Our Global Focus Strategies. Among both institutional and retail investors industry-wide, over the past few years, there has been increasing levels of investments in portfolios including non-U.S. equities. As of December 31, 2011, the total AUM in our Global Value strategies, EAFE Value strategies, Emerging Markets Value strategy, and other non-U.S. strategies was \$5.6 billion, or 41.5% of our overall AUM. Our global capability provides opportunity for all of our strategies around the world.

Employ Our Proven Process to Introduce New Products. We anticipate continuing to offer new investment strategies over time, on a measured basis, consistent with our past practice, utilizing our proven investment process.

Work with Our Strong Consultant Relationships. We believe that we have built strong relationships with the leading investment consulting firms who advise potential institutional clients. Historically, new accounts sourced through consultant-led searches have been a large driver of our inflows and are expected to be a major component of our future inflows.

Expand Our Non-U.S. Client Base. In recent years, we have increased our efforts to develop our non-U.S. client base. Through our strong relationships with global consultants, we have been able to accelerate the development of our relationships with their non-U.S. branches. Over time, we aim to achieve growth of this client base through these relationships and by directly calling on the world's largest institutional investors. In addition, during 2010 we opened a representative office in Australia to more effectively service existing clients and develop new relationships in the geographic area. To date, these marketing efforts have resulted in client relationships in more than seven non-U.S. countries, such as the United Kingdom, Australia and Canada. We have also sought to expand our non-U.S. base through our relationships with non-U.S. mutual funds and other investment fund advisors. As of December 31, 2011, we managed \$4.5 billion in separate accounts, commingled funds and sub-advised funds on behalf of non-U.S. clients.

Expand Our Sales Effort. Over the course of the last several years we have expanded our sales and marketing efforts from a team of 3 to a team of 7. This team is focused geographically along with one individual focused particularly on the subadvisory and investment-only defined contribution distribution channels. In addition to our representative office in Melbourne, Australia, we now have two other professionals dedicated to business development throughout Europe and the Middle East.

TABLE OF CONTENTS

Our Investment Team

We believe we have built an investment team that is well-suited to implementing our classic value investment strategy. The members of our investment team have a diverse set of backgrounds including former corporate management, private equity, management consulting, legal, accounting and Wall Street professionals. Their diverse business backgrounds are instrumental in enabling us to make investments in companies where we would be comfortable owning the entire business for a three- to five-year period. We look beyond temporary earnings shortfalls that result in stock price declines, which may lead others to forego investment opportunities, if we believe the long-term fundamentals of a company remain attractive.

As of December 31, 2011, we had a 23-member investment team. Each member serves as a research analyst, and certain members of the team also have portfolio management responsibilities. There are three portfolio managers for each investment strategy. These three managers have joint decision-making responsibility, and each has veto authority over all decisions regarding the relevant portfolio. For each of our largest current investment strategies, these three senior members are identified under Our Investment Strategies. Research analysts have sector and company-level research responsibilities which span all of our investment strategies, including those with a non-U.S. focus. In order to facilitate the professional development of our team, and to keep a fresh perspective on our portfolio companies, our research analysts generally rotate industry coverage every three years.

We follow a collaborative, consensus-oriented approach to making investment decisions, such that all members of our investment team, irrespective of their seniority, can play a significant role in this decision making process. We hold weekly research review meetings attended by all portfolio managers and relevant research analysts, and are open to other members of our firm, at which we openly discuss and debate our findings regarding the normalized earnings power of potential portfolio companies. In addition, we hold daily morning meetings, attended by our portfolio managers, research analysts, and portfolio administration and client service personnel, in order to review developments in our holdings and set a trading strategy for the day. These meetings are critical for sharing relevant developments and analysis of the companies in our portfolios. We believe that our collaborative culture is attractive to our investment professionals.

TABLE OF CONTENTS**Our Investment Strategies**

As of December 31, 2011, our approximately \$13.5 billion in AUM was invested in a variety of value-oriented investment strategies, representing differing capitalization segments of U.S. and non-U.S. markets. The following table describes the largest of our current U.S. and non-U.S. investment strategies, and the allocation of our approximately \$13.5 billion in AUM among them, as of December 31, 2011.

Strategy	AUM (in billions)
U.S. Strategies	
Large Cap Value	\$ 5.0
Value Service	1.6
Small Cap Value	1.0
Other U.S. Strategies ⁽¹⁾	0.3
Non-U.S. Strategies	
Global Value	3.6
EAFE Diversified Value	1.5
Other Non-U.S. Strategies ⁽²⁾	0.5
Total	\$ 13.5

(1) Our other U.S. investment strategies are: Mid Cap Value, All Cap Value and Financial Opportunities Service.

(2) Our other non-U.S. investment strategies are: EAFE Value, Global Diversified Value, European Value and Emerging Markets Value.

TABLE OF CONTENTS

We understand that our ability to retain and grow assets as a firm has been, and will be, driven primarily by delivering attractive long-term investment results to our clients. As a consequence, we have prioritized, and will continue to prioritize, investment performance over asset accumulation. Where we deemed it necessary, we have, at times, closed certain products to new investors in order to preserve capacity to effectively implement our concentrated investment strategies for the benefit of existing clients. Currently, all of our investment strategies are open to new investors.

Our five largest investment strategies as of December 31, 2011 are further described below. We follow the same investment process for each of these strategies. Our investment strategies are distinguished by the market capitalization ranges from which we select securities for their portfolios, which we refer to as each strategy's investment universe, as well as the regions in which we invest. While our investment process includes ongoing review of companies in the investment universes described below, our actual investments may include companies outside of the relevant market capitalization range at the time of our investment. In addition, the number of holdings typically found in the portfolios of each of our investment strategies may vary as described below.

U.S Strategies

Large Cap Value. We screen a universe of the 500 largest U.S.-listed companies, based on market capitalization, to build a portfolio generally consisting of 30 to 40 stocks. We launched this strategy in October 2000.

Value Service. We screen a universe of the 1,000 largest U.S.-listed companies, based on market capitalization, to build a portfolio generally consisting of 30 to 40 stocks. We launched this strategy in January 1996.

Small Cap Value. We screen a universe of U.S.-listed companies ranked from the 1,001st to 3,000th