Pzena Investment Management, Inc.
Form 10-Q
May 02, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended March 31, 2014
Or
o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ______to______

Commission file number 001-33761
PZENA INVESTMENT MANAGEMENT, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	20-8999751
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

120 West 45th Street
New York, New York 10036
(Address of Principal Executive Offices) (Zip Code)
Registrant's telephone number, including area code: (212) 355-1600

Not Applicable

(Former name, former address, and former fiscal year if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Date File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

As of May 2, 2014, there were 12,176,592 outstanding shares of the registrant’s Class A common stock, par value $0.01 per share.

As of May 2, 2014, there were 53,012,836 outstanding shares of the registrant’s Class B common stock, par value $0.000001 per share.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

Forward-looking statements are subject to known and unknown risks and uncertainties and are based on potentially inaccurate assumptions that could cause actual results to differ materially from those expected or implied by the forward-looking statements. Our actual results could differ materially from those anticipated in forward-looking statements for many reasons, including the factors described in Item 1A, “Risk Factors” in Part I of our Annual Report on Form 10-K for our fiscal year ended December 31, 2013. 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.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
PZENA INVESTMENT MANAGEMENT, INC.
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(in thousands, except share and per-share amounts)

	As of March 31, 2014 (unaudited)	December 31, 2013
ASSETS		
Cash and Cash Equivalents	$25,754	$33,878
Restricted Cash	316	316
Due from Broker	754	58
Advisory Fees Receivable	23,401	23,947
Investments, at Fair Value	12,995	7,621
Receivable from Related Parties	211	119
Other Receivables	564	550
Prepaid Expenses and Other Assets	882	577
Deferred Tax Asset, Net of Valuation Allowance of $46,849 and $53,973 in 2014 and 2013, respectively	11,337	12,312
Property and Equipment, Net of Accumulated Depreciation of $2,901 and $2,850 in 2014 and 2013, respectively	863	835
TOTAL ASSETS	$77,077	$80,213
LIABILITIES AND EQUITY		
Liabilities:		
Accounts Payable and Accrued Expenses	$6,751	$5,570
Due to Broker	5,233	5
Liability to Selling and Converting Shareholders	10,959	12,777
Lease Liability	672	778
Deferred Compensation Liability	615	2,339
Other Liabilities	104	195
TOTAL LIABILITIES	24,334	21,664
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; 12,176,592 and 12,158,057 Shares Issued and Outstanding in 2014 and 2013, respectively)	121	121
Class B Common Stock (Par Value $0.000001; 750,000,000 Shares Authorized; 52,834,679 and 52,820,720 Shares Issued and Outstanding in 2014 and 2013, respectively)	—	—
Additional Paid-In Capital	9,939	9,750
Retained Earnings	4,773	6,491
Total Pzena Investment Management, Inc.'s Equity	14,833	16,362
Non-Controlling Interests	37,910	42,187
TOTAL EQUITY	52,743	58,549
TOTAL LIABILITIES AND EQUITY	$77,077	$80,213

See accompanying notes to unaudited consolidated financial statements.

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

	For the Three Months Ended March 31,	
	2014	2013
REVENUE	$26,401	$20,842
EXPENSES		
Compensation and Benefits Expense	10,050	9,608
General and Administrative Expense	2,320	1,809
Total Operating Expenses	12,370	11,417
Operating Income	14,031	9,425
OTHER INCOME/(EXPENSE)		
Interest Income	15	27
Dividend Income	50	29
Net Realized and Unrealized Gain from Investments	104	851
Change in Liability to Selling and Converting Shareholders	(127)	(1,039)
Other (Expense)	(89)	(40)
Total Other (Expense)	(47)	(172)
Income Before Income Taxes	13,984	9,253
Income Tax Expense/ (Benefit)	1,683	(438)
Net Income	12,301	9,691
Less: Net Income Attributable to Non-Controlling Interests	10,853	8,522
Net Income Attributable to Pzena Investment Management, Inc.	$1,448	$1,169
Net Income for Basic Earnings per Share	$1,448	$1,169
Basic Earnings per Share	$0.12	$0.10
Basic Weighted Average Shares Outstanding	12,176,592	11,267,021
Net Income for Diluted Earnings per Share	$7,576	$5,806
Diluted Earnings per Share	$0.11	$0.09
Diluted Weighted Average Shares Outstanding[1]	67,929,783	66,583,836
Cash Dividends per Share of Class A Common Stock	$0.26	$0.16

1 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.

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

	Shares of Class A Common Stock	Shares of Class B Common Stock	Class A Common Stock	Additional Paid-In Capital	Retained Earnings	Non-Controlling Interests	Total
Balance at December 31, 2013	12,158,057	52,820,720	$121	$9,750	$6,491	$ 42,187	$58,549
Amortization of Non-Cash Compensation	18,535	17,435	—	161	—	700	861
Directors' Shares	—	—	—	22	—	94	116
Net Income	—	—	—	—	1,448	10,853	12,301
Repurchase and Retirement of Class B Units	—	(3,476)	—	(8)	—	(33)	(41)
Class A Cash Dividends Declared and Paid ($0.26 per share)	—	—	—	—	(3,166)	—	(3,166)
Contributions from Non-Controlling Interests	—	—	—	—	—	948	948
Distributions to Non-Controlling Interests	—	—	—	—	—	(16,825)	(16,825)
Other	—	—	—	14	—	(14)	—
Balance at March 31, 2014	12,176,592	52,834,679	$121	$9,939	$4,773	$ 37,910	$52,743

See accompanying notes to unaudited consolidated financial statements.

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

	For the Three Months Ended March 31,	
	2014	2013
OPERATING ACTIVITIES		
Net Income	$12,301	$9,691
Adjustments to Reconcile Net Income to Cash Provided by Operating Activities:		
Depreciation	53	39
Non-Cash Compensation	1,476	1,294
Director Share Grant	116	75
Net Realized and Unrealized (Gain) from Investments	(104)	(851)
Change in Liability to Selling and Converting Shareholders	127	1,039
Deferred Income Taxes	970	(434)
Changes in Operating Assets and Liabilities:		
Advisory Fees Receivable	546	(2,175)
Due from Broker	(696)	(1,617)
Restricted Cash	—	(1)
Prepaid Expenses and Other Assets	(319)	(793)
Due to Broker	5,228	1,626
Accounts Payable, Accrued Expenses, and Other Liabilities	(1,244)	1,079
Tax Receivable Agreement Payments	(1,945)	(2,000)
Change in Lease Liability	(106)	(106)
Purchases of Investments	(15,355)	(33,260)
Proceeds from Sale of Investments	10,063	33,698
Net Cash Provided by Operating Activities	11,111	7,304
INVESTING ACTIVITIES		
Purchases of Investments in Deferred Compensation Plan	(519)	(1,459)
Proceeds from Investments in Deferred Compensation Plan	541	78
Payments from/ (to) Related Parties	(92)	(47)
Purchase of Property and Equipment	(81)	—
Net Cash (Used in)/Provided by Investing Activities	(151)	(1,428)
FINANCING ACTIVITIES		
Repurchase and Retirement of Class A Common Stock	—	(667)
Repurchase and Retirement of Class B Units	(41)	—
Distributions to Non-Controlling Interests	(16,825)	(11,623)
Contributions from Non-Controlling Interests	948	—
Dividends	(3,166)	(1,772)
Net Cash Used in Financing Activities	(19,084)	(14,062)
NET CHANGE IN CASH	$(8,124)	$(8,186)
CASH AND CASH EQUIVALENTS - Beginning of Period	$33,878	$32,645
Net Change in Cash	(8,124)	(8,186)
CASH AND CASH EQUIVALENTS - End of Period	$25,754	$24,459
Supplementary Cash Flow Information:		
Income Taxes Paid	$891	$869

See accompanying notes to unaudited consolidated financial statements.

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Pzena Investment Management, Inc.
Notes to Unaudited Consolidated Financial Statements

Note 1—Organization

Pzena Investment Management, Inc. (the "Company") 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 March 31, 2014, 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 has consolidated the results of operations and financial condition of the following entities as of March 31, 2014:

Legal Entity	Type of Entity (Date of Formation)	Operating Company's Ownership at March 31, 2014	
Pzena Investment Management, Pty	Australian Proprietary Limited Company (12/16/2009)	100.0	%
Pzena Financial Service, LLC	Delaware Limited Liability Company (10/15/2013)	100.0	%
Pzena Emerging Markets Focused Value Fund, a series of Advisors Series Trust	Open-end Management Investment Company, series of Delaware Statutory Trust (3/31/2014)	100.0	%
Pzena Long/Short Value Fund, a series of Advisors Series Trust	Open-end Management Investment Company, series of Delaware Statutory Trust (3/31/2014)	100.0	%
Pzena Mid Cap Focused Value Fund, a series of Advisors Series Trust	Open-end Management Investment Company, series of Delaware Statutory Trust (3/31/2014)	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)	—	%
Pzena International Value Service, a series of Pzena Investment Management International, LLC	Delaware Limited Liability Company (12/22/2003)	—	%

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. The Company also consolidates variable-interest entities (“VIEs”) where the Company is deemed to be the primary beneficiary. 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.” 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.

On March 31, 2014, the operating company launched the Pzena Emerging Markets Focused Value Fund, Pzena Long/Short Value Fund, and Pzena Mid Cap Focused Value Fund, for which it acts as the investment advisor. On March 31, 2014, the Company provided the initial cash investment in an effort to generate an investment performance track record to attract third-party investors. As of March 31, 2014, the Company had an initial investment representing 100% of the ownership in each entity. As a result, the entities were consolidated with the Company as of March 31, 2014. At March 31, 2014, the aggregate of Pzena Emerging Markets Focused Value Fund, Pzena Long/Short Value Fund, and Pzena Mid Cap Focused Value Fund's $6.0 million in net assets were included in the Company's consolidated statements of financial condition. The operating company, as Investment Manager of these funds, has contractually agreed to waive a portion or all of its management fees and pay fund expenses to ensure that the annual operating expenses of the funds stay below certain established total expense ratio thresholds. No such expenses were recognized during three months ended March 31, 2014.

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 March 31, 2014, the Pzena Large Cap Value Fund's $1.1 million in net assets were included in the Company's consolidated statements of financial condition.

The operating company is the managing member of Pzena International Value Fund. The operating company is considered the primary beneficiary of this entity. As a result, the entity was consolidated as of February 1, 2011. At March 31, 2014, Pzena International Value Fund's $2.3 million in net assets were included in the Company's consolidated statements of financial condition.

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 Non-U.S. Value Strategies. The total net assets of these VIEs was approximately $270.5 million and $244.2 million at March 31, 2014 and December 31, 2013, respectively. Neither the Company nor the operating company were exposed to losses as a result of its involvement with these entities because they had no direct investment in them.

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

Management's Use of Estimates:

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

Fair Values of Financial Instruments:

The carrying amounts of all financial instruments in the consolidated statements of financial condition are presented at their fair value.

Revenue Recognition:

Revenue, comprised of advisory fee income, is recognized over the period in which advisory services are provided. Advisory fee income includes management fees that are calculated based on percentages of assets under management ("AUM"), generally billed quarterly, either in arrears or advance, depending on their contractual terms. Advisory fee income also includes performance fees that may be earned by the Company depending on the investment return of the assets under management. Performance fee arrangements generally entitle the Company to participate, on a fixed-percentage basis, in any returns generated in excess of an agreed-upon benchmark. The Company's participation percentage in such return differentials is then multiplied by AUM to determine the performance fees earned. In general, returns are calculated on an annualized basis over the contract's measurement period, which usually extends to three years. Performance fees are generally payable annually. Following the preferred method identified in the Revenue Recognition Topic of the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC"), such performance fee income is recorded at the conclusion of the contractual performance period, when all contingencies are resolved. For the three months ended March 31, 2014 and 2013, the Company recognized approximately $0.3 million and less than $0.1 million in performance fee income, respectively.

Cash and Cash Equivalents:

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At March 31, 2014 and December 31, 2013, Cash and Cash Equivalents was $25.8 million and $33.9 million, respectively. The Company considers all money market funds and highly-liquid debt instruments with an original maturity of three months or less at the time of purchase to be cash equivalents. The Company maintains its cash in bank deposits and other accounts whose balances often exceed federally insured limits.

Interest on cash and cash equivalents is recorded as interest income on an accrual basis in the consolidated statements of operations.

Restricted Cash:

The Company maintained compensating balances of $0.3 million at March 31, 2014 and December 31, 2013 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 in the consolidated statements of financial condition.

Due to/from Broker:

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

Investments, at Fair Value:

Investments, at Fair Value represents the securities held by the Company and its consolidated subsidiaries, as well as investments in third-party mutual funds. The Company's investments in third-party mutual funds are held to satisfy the Company's obligations under its deferred compensation program. Dividends associated with the investments of the Company's consolidated subsidiaries are recorded as dividend income on an ex-dividend basis in the consolidated statement of operations.

All such investments are recorded at fair value, with net realized and unrealized gains and losses reported in earnings in the consolidated statements of operations.

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

The Company's fair value measurements relate to its consolidated investments in equity securities, which are exchange-traded securities with quoted prices in active markets, and its investments in third-party mutual funds, which have a readily available net asset value per share. The fair value measurements of the equity securities and investments in mutual funds have been classified as Level 1.

The following table presents these instruments' fair value at March 31, 2014:

	Level 1	Level 2	Level 3
	(in thousands)		
Assets:			
Equity Securities	$7,722	$—	$—
Investments in Mutual Funds	5,273	—	—
Total Fair Value	$12,995	$—	$—

The following table presents these instruments' fair value at December 31, 2013:

	Level 1	Level 2	Level 3
	(in thousands)		
Assets:			
Equity Securities	$2,364	$—	$—
Investments in Mutual Funds	5,257	—	—
Total Fair Value	$7,621	$—	$—

For the three months ended March 31, 2014 and 2013, there were no transfers between levels. In addition, the Company did not hold any Level 2 or 3 securities during these periods.

Securities Valuation:

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

The net realized gain or loss on sales of securities and investments in third-party mutual funds is determined on a specific identification basis and is included in Net Realized and Unrealized Gain/(Loss) from Investments in the consolidated statements of operations.

Concentrations of Credit Risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, amounts due from brokers, and advisory fees receivable. The Company maintains its cash and cash equivalents in bank deposits and other accounts whose balances often exceed federally insured limits.

The concentration of credit risk with respect to advisory fees receivable is generally limited due to the short payment terms extended to clients by the Company. On a periodic basis, the Company evaluates its advisory fees receivable and establishes an allowance for doubtful accounts, if necessary, based on a history of past write-offs and collections and current credit conditions. At March 31, 2014 and December 31, 2013, no allowance for doubtful accounts was deemed necessary.

Property and Equipment:

Property and equipment is carried at cost, less accumulated depreciation and amortization. Depreciation is provided on a straight-line basis over the estimated useful lives of the respective assets, which range from three to seven years. Leasehold improvements are amortized on a straight-line basis over the shorter of the useful life of the improvements or the remaining lease term.

Business Segments:

The Company views its operations as comprising one operating segment.

Income Taxes:

The Company is a "C" corporation under the Internal Revenue Code, and thus liable for federal, state, and local taxes on the income derived from its economic interest in its operating company. The operating company is a limited liability company that has elected to be treated as a partnership for tax purposes. It has not made a provision for federal or state income taxes because it is the individual responsibility of each of the operating company's members (including the Company) to separately report their proportionate share of the operating company's taxable income or loss. Similarly, the income of the Company's consolidated subsidiaries 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").

Judgment is required in evaluating the Company's uncertain tax positions and determining its provision for income taxes. The Company establishes reserves for tax-related uncertainties based on estimates of whether, and the extent to which,

additional taxes will be due. These reserves are established when the Company believes that certain positions might be challenged despite its belief that its tax return positions are in accordance with applicable tax laws. The Company adjusts these reserves in light of changing facts and circumstances, such as the closing of a tax audit, new tax legislation, or the change of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will affect the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the effect of reserve provisions and changes to reserves that are considered appropriate. It is also the Company's policy to recognize accrued interest, and penalties associated with uncertain tax positions in Income Tax Expense/(Benefit) on the consolidated statement of operations. For the three months ended March 31, 2014 and 2013, no such expenses were recognized. As of March 31, 2014 and December 31, 2013, no such accruals were recorded.
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 carrying amount and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the periods in which the temporary differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount more likely than not to be realized. At March 31, 2014, the Company had a $46.8 million valuation allowance against deferred tax assets recorded as part of the Company's initial public offering and the subsequent exchanges of Class B units for shares of its Class A common stock. At December 31, 2013, the Company had a $54.0 million valuation allowance against these deferred tax assets. The income tax expense, or benefit, is the tax payable or refundable for the period, plus or minus the change during the period in deferred tax assets and liabilities. The Company records its deferred tax liabilities as a component of other liabilities in the consolidated statements of financial condition.

Excess tax benefits related to stock- and unit-transactions are not recognized until they result in a reduction of cash taxes payable. The benefit of these excess tax benefits will be recorded in equity when they reduce cash taxes payable. The Company will only recognize a tax benefit from stock- and unit-based awards in Additional Paid-In Capital if an incremental tax benefit is realized after all other tax benefits currently available have been utilized. For the three months ended March 31, 2014, the Company had less than $0.1 million in tax benefits associated with stock- and unit-based awards that it was not able to recognize. There were no unrecognized tax benefits for the three months ended March 31, 2013.

Foreign Currency:

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

The Company does not isolate the portion of the results of its operations resulting from the impact of fluctuations in foreign exchange rates on its non-U.S. investments. Such fluctuations are included in Net Realized and Unrealized Gain/(Loss) from Investments in the consolidated statements of operations.

Reported net realized foreign exchange gains or losses arise from sales of foreign currencies, currency gains or losses realized between the trade and settlement dates on securities transactions, and the difference between the amounts of dividends, interest, and foreign withholding taxes recorded on the Company's books and the U.S. dollar equivalent of the amounts actually received or paid. Net unrealized foreign exchange gains and losses arise from changes in the fair values of assets and liabilities resulting from changes in exchange rates.

The functional currency of the Company is the United States Dollar. The functional currency of the Company's representative office in Australia is the Australian Dollar. Assets and liabilities of this office are translated at the spot rate in effect at the applicable reporting date, and the consolidated statements of operations are translated at the average exchange rates in effect during the applicable period. For the three months ended March 31, 2014 and 2013, the Company did not record any accumulated other comprehensive income.

Note 3—Compensation and Benefits

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

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

	For the Three Months Ended March 31,	
	2014	2013
	(in thousands)	
Cash Compensation and Other Benefits	$ 8,574	$ 8,388
Non-Cash Compensation	1,476	1,220
Total Compensation and Benefits Expense	$ 10,050	$ 9,608

All non-cash compensation awards granted have varying vesting schedules and are issued at prices equal to the assessed fair market value at the time of issuance, as discussed below. Details of Class B units, phantom Class B units and restricted shares of Class A common stock awarded during the three months ended March 31, 2014 and 2013 are as follows:

	For the Three Months Ended March 31,			
	2014		2013	
	Amount	Fair Value[1]	Amount	Fair Value[1]
Class B Units	32,479	$ 11.76	18,517	$ 5.40
Deferred Compensation Phantom Class B Units	22,959	$ 11.76	68,518	$ 5.40
Restricted Shares of Class A Common Stock	—	$—	100,000	$ 4.41

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

Pursuant to the Pzena Investment Management, LLC Amended and Restated 2006 Equity Incentive Plan ("the 2006 Equity Incentive Plan"), the operating company issues Class B units, phantom Class B units and options to purchase Class B units. Under the Pzena Investment Management, Inc. 2007 Equity Incentive Plan ("the 2007 Equity Incentive Plan"), the Company issues shares of restricted Class A common stock and options to acquire shares of Class A common stock.

Under the Pzena Investment Management, LLC Amended and Restated Bonus Plan (the "Bonus Plan"), eligible employees whose cash compensation is in excess of certain thresholds have a portion of that excess mandatorily deferred. These deferred amounts may be invested, at the employee's discretion, in certain third-party mutual funds, phantom Class B units, or money market funds. Amounts deferred in any calendar year reduce that year's cash compensation expense and are amortized and vest ratably over a four-year period commencing the following year. As of March 31, 2014 and December 31, 2013, the liability associated with deferred compensation investment accounts was $0.6 million and $2.3 million, respectively.

Pursuant to the Pzena Investment Management, Inc. Non-Employee Director Deferred Compensation Plan (the "Director Plan"), non-employee directors may elect to have all or part of the compensation otherwise payable to the director in cash, deferred in the form of phantom shares of Class A common stock of the Company. Elections to defer compensation under the Director Plan are made on a year-to-year basis. Distributions under the Director Plan shall be made in a single distribution of shares of Class A common stock at such time as elected by the participant when the deferral was made. Since inception of the Director Plan in 2009, the Company's directors have elected to defer 100% of their compensation in the form of phantom shares of Class A common stock. Amounts deferred in any calendar year are amortized over the calendar year and reflected as General and Administrative Expense. As of March 31, 2014 and December 31, 2013, there were 188,620 and 158,882 phantom shares of Class A common stock outstanding, respectively. For the three months ended March 31, 2014 and 2013 no distributions were made under the Director plan.

The Company issues to certain of its employees delayed-vesting cash awards. For the three months ended March 31, 2014 and 2013 no such awards were granted. Previously awarded delayed-vesting cash awards have varying vesting schedules with $1.1 million to be paid at the end of 2014 and the remaining $0.4 million to be paid at the end of 2015.

As of March 31, 2014 and December 31, 2013, the Company had approximately $28.7 million and $29.7 million, respectively, in unrecorded compensation expense related to unvested awards issued pursuant to its Bonus Plan; Class B units, option grants, and phantom Class B units issued under the 2006 Equity Incentive Plan; and restricted Class A common stock issued under the 2007 Equity Incentive Plan. The Company anticipates that this unrecorded cost will amortize over the respective vesting periods of the awards.

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Note 4 – Employee Benefit Plans

The operating company has a Profit Sharing and Savings Plan for the benefit of substantially all employees. The Profit Sharing and Savings Plan is a defined contribution profit sharing plan with a 401(k) deferral component. All full-time employees and certain part-time employees who have met the age and length of service requirements are eligible to participate in the plan. The plan allows participating employees to make elective deferrals of compensation up to the annual limits which are set by law. The plan provides for a discretionary annual contribution by the operating company which is determined by a formula based on the salaries of eligible employees as defined by the plan. For the three months ended March 31, 2014 and 2013, the expense recognized in connection with this plan was $0.3 million and $0.2 million, respectively.

Note 5—Earnings per Share

Basic earnings per share is computed by dividing the Company's net income attributable to its common stockholders by the weighted average number of shares outstanding during the reporting period. For the three months ended March 31, 2014 and 2013, the Company's basic earnings per share was determined as follows:

	For the Three Months Ended March 31,	
	2014	2013
	(in thousands, except share and per share amounts)	
Net Income for Basic Earnings per Share	$ 1,448	$ 1,169
Basic Weighted-Average Shares Outstanding	12,176,592	11,267,021
Basic Earnings per Share	$ 0.12	$ 0.10

Diluted earnings per share adjusts this calculation to reflect the impact of all outstanding operating company membership units, phantom Class B units, phantom Class A common stock, outstanding Class B unit options, options to purchase Class A common stock, and restricted Class A common stock, 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 outstanding operating company membership units are converted into Company stock at the beginning of the reporting period and the resulting change to Company net income associated with its increased interest in the operating company is taxed at the Company's effective tax rate, exclusive of adjustments associated with both the valuation allowance and the liability to selling and converting shareholders and other one-time charges.

For the three months ended March 31, 2014 and 2013, the Company's diluted net income was determined as follows:

	For the Three Months Ended March 31,	
	2014	2013
	(in thousands)	
Net Income Attributable to Non-Controlling Interests of Pzena Investment Management, LLC	$ 10,780	$ 8,114
Less: Assumed Corporate Income Taxes	4,652	3,477
Assumed After-Tax Income of Pzena Investment Management, LLC	6,128	4,637
Net Income of Pzena Investment Management, Inc.		